U.S. SMALL BUSINESS ADMINISTRATION BUDGET REQUEST FY 2002

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BEFORE THE

COMMITTEE ON SMALL BUSINESS
HOUSE OF REPRESENTATIVES

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U.S. SMALL BUSINESS ADMINISTRATION BUDGET REQUEST FY 2002

WEDNESDAY, MAY 16, 2001

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The committee met, pursuant to call, at 10:10 a.m. in Room 2360, Rayburn House Office Building, Hon. Donald Manzullo (chairman of the Committee) presiding.

Chairman MANZULLO. The committee will be called to order, if the panel would be seated. I am going to go ahead and read my opening statement.

Good morning and welcome to this hearing of the Committee on Small Business. A special welcome to those who have come some distance to participate and to attend this hearing. I applaud those parts of the president's budget which will fund America's important priorities, that reduce the federal debt, and that provide for tax relief for the American people, including a decrease in the marginal rates which will greatly help out a lot of small business people throughout the nation.

However, I disagree with a number of items contained in the president's budget request for the Small Business Administration and I am particularly disappointed that the budget was made up without any input from the chairmen of the respective committees, including this chairman.

Specifically, I disagree with the increases in the fees for the 7(a) loan program when the budget submission shows a substantial surplus. In fact, these fees should be decreased.

Last year, $171 million extra came in over and above what was necessary for the 7(a) program. The subsidy rate has been unfairly set so the borrowers are paying more for the user fee. They are effectively paying an additional tax.

I disagree with the increase in the interest rate for loans for the businesses without credit under the disaster loan program. I do not know how anyone could suggest increasing fees for persons who have just lost their businesses as a result of a flood or earthquake. This proposal is a double disaster to them. In fact, it is apparent by looking at these fee increases that the budget is attempting to tax small business people as a revenue raiser to fund other programs.

I disagree with the proposal to charge fees for persons seeking business advice from the local Small Business Development Centers. Is the administration going to charge farmers for assistance from the Department of Agriculture or the taxpayer who calls the IRS 800 number?

I also disagree with the failure to request funding for three technical assistance programs. There may be some redundancy, but a case has not been made as to how the SBA intends to make up for the services small businesses would lose if the programs were terminated.

As you can see, I am concerned about the specifics of the president's budget as it impacts the SBA. You may be assured that I will remain concerned until the issues are resolved.

I would ask as the witnesses testify, especially with regard to the 7(a) loan programs, how they can justify an increase in fees in light of the fact that based upon the exhibit that we have over there in the lower left-hand corner, it demonstrates the tremendous amount of surplus, in fact, almost $600 million in surplus fees have been generated by fees taxed to the small business people while at the same time the administration budget attempts to increase those fees.

Again, I appreciate your attending this hearing. I look forward to the testimony of our witnesses and I yield for an opening statement from my good friend, Mrs. Velázquez, the ranking minority member from New York.

[Chairman Manzullo's statement may be found in appendix.]

Ms. VELÁZQUEZ. Thank you, Mr. Chairman.

Earlier this year when we met to consider the Small Business Administration budget request, I said at the time that this budget was without a doubt the worst I have seen in my three years as ranking member and my nine years of service on this committee.

Mr. Chairman, I have seen nothing in this budget that changes that opinion, nor am I likely to. One of the critical roles that SBA plays in helping small businesses is providing for those who cannot, for whatever reason, receive access to the capital necessary to either start or grow their business. That is why this proposal to replace the current SBA loan appropriations with a fee system is so dangerous and, indeed, reckless. For example, the average small business borrower in the 7(a) program will under this proposed structure pay thousands of dollars in up front and ongoing costs.

And with these costs attached to both borrowers and lenders, we will create a situation where fewer and fewer banks offer these loans and therefore close off a vital source of capital to small business owners.

Is that what we should be doing in an economy that has more questions than answers? Should we not be making it easier to access these programs so that small businesses, the real economic foundation of this country, can help lead us back to prosperity as they have done in the past?

This budget is a formula for disaster. By cutting off access to capital, you are cutting off access to opportunity. It is just that simple.

To add insult to serious injury, the president's budget proposes to impose fees on the critical disaster loan program. As a result, many entrepreneurs will never be able to rebuild their businesses without being saddled with a literal mountain of debt, so the business and the jobs it provides are gone forever. And I wonder, is this what President Bush meant when he campaigned as a compassionate conservative?

What is even more alarming is that under this budget small business will be forced to pay for the counseling and technical assistance provided through the Small Business Development Center program. And those of you who have owned a small business know that businesses receiving critical technical assistance are more likely to succeed than those that do not.

These new fees will force many businesses, many of whom can hardly afford added expenses, to go without technical assistance. The result, the business community will be subjected to increased business failure and bankruptcies. Somehow, I do not think that that is something we need in this economy.

What concerns me is that the vast majority of SBDCs are located in minority communities that are trying to build a new life in areas that economic prosperity has somehow forgotten. And now we tell them just wait a little longer because we have to get the economy back on track.

Well, I am here to tell you that these communities cannot wait any longer. These entrepreneurs as well as others around the country need help now, not when this cut finally trickles down to them. That is why it makes absolutely no sense to me that this budget chooses to eliminate programs like PRIME, BusinessLINC and the New Market Venture Capital Program.

Not coincidentally, these were programs aimed at building new economic anchors who have yet to benefit from the boom of the last decade. Let me say for the record that this budget has failed in both houses of Congress and in a very bipartisan fashion.

My colleagues, everyone on this committee knows the important role that small business has played in our nation's economy. That is why this budget represents such a disconnect between the White House and the reality of this economy.

In closing, let me say simply that this is a bad budget and it will be bad for small business. This budget fails us in so many ways, particularly given the fact that this proposal does not take into account that the economy is no longer operating at peak efficiency. We must have a budget that recognizes these changes and puts us back on the road toward economic growth. Without a reasonable budget plan, we are placing America's economic foundation and the key to future prosperity at risk of failure. It is something that none of us can afford.

And, as my father always told me, "If you fail to plan, plan to fail." Small business owners and future entrepreneurs are counting on us to do the right thing by them. Let us not let them down by passing an irresponsible budget.

Thank you, Mr. Chairman.

[Ms. Velázquez's statement may be found in appendix.]

Chairman MANZULLO. There is a vote. What I am going to do is I am going to adjourn here.

Congressman Issa went over to vote early. As soon as he comes back, he will start in with the testimony, as long as there is a member from the minority present.

[Recess.]

Mr. ISSA [presiding]. Thank you all for your patience. We will now begin with our panel of witnesses, beginning with Mr. John Whitmore, Jr., Acting Administrator of the Small Business Administration, and then we will introduce the rest of the panel later.

Mr. Whitmore.

STATEMENT OF JOHN WHITMORE, JR., ACTING ADMINISTRATOR, UNITED STATES SMALL BUSINESS ADMINISTRATION

Mr. WHITMORE. Thank you, Mr. Chairman, Madam Ranking Member, and members of the committee. Thank you for inviting me here today. I am pleased to present the Small Business Administration's budget request for fiscal year 2002. I ask that my full written statement be submitted for the record.

Mr. ISSA. Without objection, so ordered.

Mr. WHITMORE. With me today is Greg Walter, the Deputy Chief Financial Officer at SBA.

The budget request of $539 million represents a renewed focus on SBA's core programs. It will provide credit, capital and technical assistance to America's small businesses at a substantially reduced cost to the taxpayer. It includes $5 million for SBA's portion of the president's new Freedom Initiative to help small businesses comply with the Americans with Disabilities Act and $5 million as part of the Paul G. Coverdale Drug Free Workplace program. The budget also seeks to streamline the agency.

The budget proposes funding SBA technical assistance programs at last year's level with three exceptions. We are proposing to increase the funding for the SCORE program by $250,000 to $4 million. SCORE is one of SBA's most cost-efficient programs and will soon implement an electronic delivery system to broaden its reach.

The Veterans' Business Development Program was not funded in 2001 but will receive $750,000 in 2002.

The budget proposes a funding level of $88 million for the Small Business Development Center Program, $75.8 million coming from appropriations and $12 million in fees.

Some SBDCs already impose a variation on the counseling fee by requiring new start-up businesses to take the training course at a cost between $35 and $45 before receiving counseling. This is also in line with other SBA technical assistance programs. Charging a modest fee of under $11 an hour will maintain the current service level, while reducing the expense to the taxpayer.

The budget proposes funding the Government Contract Assistance programs at the 2001 level. However, it does include $500,000 for a women's contract initiative study and a contract bundling study.

The budget fairly demands that those who benefit most from SBA programs share in its costs. In the exact language of the president's budget, these programs will become self-financing by increasing fees. The budget acknowledges that some small businesses may have trouble accessing private capital in the absence of a government guarantee, but does not require the government to subsidize the cost of borrowing. The budget increases fees sufficiently to make these programs self-financing and would save $141 million. This will reduce the burden on appropriation, will allow for expanded program levels and is fair to the taxpayer.

The budget proposes increasing fees in the Small Business Loan program and in the Small Business Investment Company program. In the Small Business Loan Program, the budget raises fees for small business loans above $150,000. There is no fee increase for loans made under the $150,000 benchmark and continues the rebate to the lender.

We hope this will encourage small loans to those that are in the start-up phase of business. This will also serve to provide capital to those most in need and will support a zero subsidy rate.

The new administrator faces many challenges once confirmed. Two principal challenges include antiquated programs and delivery systems that are out of touch with today's dynamic small business environment and resource and personnel questions. SBA needs to transform itself into an entity that is governed by efficiency, flexibility and the empowerment of small business through knowledge.

More specifically, within the SBA Business Loan Program, the number of loans has decreased 21 percent in the last five years, while the dollar volume of the loans have increased 26 percent. While the dollar volume has increased, the Small Business Loan Program suffers from a lack of reach. Larger loans have gone to fewer companies. This is where SBA faces the biggest challenge, cultivating small businesses in their initial stage of growth is crucial in advancing America's small business community. This is where SBA should focus its attention. This is true gap lending.

The fastest growing groups in America's small business community are Hispanic and women-owned businesses. These groups, along with African-American, Native American and veterans, are also the most underrepresented in SBA's Small Business Loan Program.

Another challenge facing us is the need to focus on the current organizational and functional structure of SBA. This challenge has been exacerbated in recent months by the hiring of 70 people in the November–January time period without regard to the agency's top priorities of loan monitoring and lender oversight.

We also recognize the need to emphasize performance measures. We have addressed internally the measures we need to focus on and are working to implement a reliable system to increase accountability.

I would also like to address SBA's loan monitoring project which was authorized in December 1997. After determining that the project had run off course, I directed the program to refocus on that which Congress authorized and appropriated. With this in mind, we have signed a contract with KPMG to provide us with expert assistance in assessing the available options. Other elements of our modernization effort will wait until the loan monitoring system is fully operational.

Thank you. I will be pleased to answer questions.

[Mr. Whitmore's statement may be found in appendix.]

Chairman MANZULLO [presiding]. Ms. Velázquez.

Ms. VELÁZQUEZ. Thank you, Mr. Chairman.

Mr. Whitmore, welcome and thank you for your testimony. I know, sir, that this is not your budget, so you are today in the hot seat and that you get hazard pay for today.

Mr. Whitmore, you stated in your testimony that from fiscal year 1995 through fiscal year 2000, 7(a) loan levels have declined. I would like you to look at the following charts, sir.

Looking at loan levels back to fiscal year 1992, you get a far different picture. In fact, 7(a) lending overall and lending to both Hispanics an African-Americans has steadily increased.

This being the case, why do you choose to go back to fiscal year 1995 in your testimony?

Mr. WHITMORE. Well, I picked 1995 because it was really the highest year of our production and we moved from that year on.

Ms. VELÁZQUEZ. Mr. Whitmore, is it not true that 1995 was the year SBA announced the LowDoc program which at first attracted a high industry interest but nine months later when SBA published the regulations and they were not what SBA led lenders to believe, many dropped out from the program?

Mr. WHITMORE. I know that was the year that we initiated the LowDoc. I do not know what the dropout rate was.

Ms. VELÁZQUEZ. So you did not make a connection between the new regs and the fact that many lenders decided to drop out?

Mr. WHITMORE. No, we just picked the year that—we looked at the highest production year we had.

Ms. VELÁZQUEZ. Sir, is this trend not more reflective of SBA mishandling of a program than lack of lender interest?

Chairman MANZULLO. Excuse me a second. Could you pull the mike closer? Thank you.

Mr. WHITMORE. The downward trend, ma'am?

Ms. VELÁZQUEZ. Yes.

Mr. WHITMORE. I think it is a lack of focus in management on the areas in which we really want to participate. What we are seeing is the two fastest growing communities, women-owned businesses and Hispanic-owned businesses, where we should see a trend upward in the last few years without even having a specific focus and we are not seeing that.

Ms. VELÁZQUEZ. Do you have more information?

Mr. WALTER. My name is Greg Walter, the SBA Deputy CFO.

Ms. VELÁZQUEZ. Yes?

Mr. WALTER. During that same time period, the guaranteed percentage on the loan was lowered and the fees were also raised; We think those are also contributing factors to some of the downturn in the volume in the 7(a) program.

Ms. VELÁZQUEZ. Mr. Whitmore, according to SBA's statistics, 7(a) loan volume declined by 18 percent from 1995 to 1996. Is that correct?

Mr. WHITMORE. Ma'am——

Ms. VELÁZQUEZ. Yes or no?

Mr. WHITMORE. I do not know.

Ms. VELÁZQUEZ. You do not know?

Mr. WHITMORE. We do not have the exact numbers for 1995 to 1996.

Ms. VELÁZQUEZ. Can you get an answer, a written answer to that question?

Mr. WHITMORE. Can you hold one second on total loans?

Ms. VELÁZQUEZ. Can you look at the chart?

Mr. WHITMORE. I have a chart. What years again, ma'am?

Ms. VELÁZQUEZ. From 1995 to 1996. The 7(a) loan volume declined by 18 percent.

Mr. WHITMORE. It declined from $8.2 billion to $7.7 billion.

Ms. VELÁZQUEZ. Can you look at the chart? What 7(a) fee changes were implemented in 1995 to respond to what was determined by CBO to be a regularly miscalculated 7(a) subsidy rate?

Mr. WHITMORE. I cannot answer the subsidy rate question.

Ms. VELÁZQUEZ. Well, I have an answer for you. The guaranteed percentage was dropped from 90 percent to 80 percent and a 50 basis point fee was imposed on the outstanding balance of every 7(a) loan.

Mr. WHITMORE. I was not sure what year that was. I take it that is accurate.

Ms. VELÁZQUEZ. You do not know? And the gentleman?

Mr. WALTER. It did happen during that period. That is correct.

Ms. VELÁZQUEZ. Thank you. So in 1995, in response to continued miscalculation of the 7(a) subsidy rate, the cost for the 7(a) lenders and borrowers was increased, right?

Mr. WALTER. As a result of the subsidy rate calculation, the fees were changed.

Ms. VELÁZQUEZ. Yes or no?

Mr. WALTER. That is correct.

Ms. VELÁZQUEZ. Yes.

Mr. WALTER. That is correct.

Ms. VELÁZQUEZ. And, as a result, the market responded by having 18 percent fewer loans made. Is that correct?

Mr. WALTER. Yes, ma'am.

Ms. VELÁZQUEZ. Do not small businesses that need more than $150,000 loan deserve access to the 7(a) program?

Mr. WHITMORE. Yes, we believe they do deserve access.

Ms. VELÁZQUEZ. So how are businesses going to get access when history has proven that increasing lender and borrower costs just causes the program to shrink? How are they going to get it when the federal regulators prompt banks to tighten loan underwriting criteria and conventional small loans of any kind become scarce like they have in the past?

Mr. WHITMORE. Well, we believe on loans of a million dollars or any over the $150,000 level that the increase is not that large and would not affect demand at this particular point.

Ms. VELÁZQUEZ. Sir, history is there to tell us that when you increase the cost for lenders and borrowers we are going to have less volume of loans. I am not coming up with that, that is what history is telling us.

Mr. WHITMORE. I see that, but there are also other——

Ms. VELÁZQUEZ. My next question, sir. In light of the fact that over the last ten years the SBA has returned over $1 billion in fee overpayments from the 7(a) program to the Treasury Department, what steps has the CFO's office taken to correct what CBO, the President's budget and this committee have found to be continued errors in calculating the 7(a) subsidy rate?

Mr. WALTER. Congresswoman, we have been looking at the model continually for the last few years, as I am sure you are aware; We have recognized the trends that you have identified in that the default rates, the actual default rates of the portfolio, have been much less than what were modeled in the subsidy rate models.

Ms. VELÁZQUEZ. Sir, every year that you have come before this committee it is the same answer. So if year after year, year in, year out, the 7(a) subsidy calculation has been so wrong and the margin of error fails to improve, so tell me, has not the credit subsidy calculation just become an increase to increase borrower and lender fees in order to shrink the 7(a) program size? Yes? No?

Mr. WALTER. I believe the model as developed and used serves a useful purpose for looking at a long-term cost of the programs. Because of what the results are and have been in the recent years, it probably deserves to be revisited again this year. You are correct.

Chairman MANZULLO. Thank you, Ms. Velázquez.

I have just a couple——

Ms. VELÁZQUEZ. Well, I will continue to—when we finish here, Mr. Chairman, I did not finish and I need to ask some more questions.

Chairman MANZULLO. I have a couple of questions.

If somebody could remove those first two charts on the board closest to me—there we are. Thank you.

Mr. Whitmore, the lower left-hand corner of that is a page out of the budget. That is page 1092 out of the budget, starting at functions 2330, 7(a) downward re-estimate. Do you see those figures there?

Mr. WHITMORE. Yes, we have them.

Chairman MANZULLO. Where does it start? Actually, starting at 2330, General Business 7(a), do you see that up on the chart there?

Mr. WHITMORE. Yes, sir.

Chairman MANZULLO. Could you explain what that means?

Mr. WHITMORE. Greg Walter will explain the subsidy area.

Chairman MANZULLO. Okay. Could you pull the mike closer to your mouth and spell your last name for the record, please?

Mr. WALTER. The name is Greg Walter. The last name is W-a-l-t-e-r.

Chairman MANZULLO. Okay. Go ahead.

Mr. WALTER. Mr. Chairman, what these reflect are that the subsidy rate process that the agency undergoes. Federal credit reform requires us to do two things each year. It requires us to calculate the estimated cost of the loan program for the budget year into the future, so we develop a subsidy rate estimate for the future year. It also requires us to look backwards at the subsidy rates that have been provided for the past year since credit reform was passed in 1992 and to recalculate those subsidy rates based on the most current knowledge we have about the performance of the portfolio.

What you are seeing in these charts is what we call the re-estimated calculations of the subsidy rates for the loans that were made prior to 2001. These are funds that in fact are being returned to the Treasury as a result of the actual costs of the program being less than what we had estimated them to be when the subsidy was first developed.

Chairman MANZULLO. So it is overpayment of fees.

Mr. WALTER. It is a reflection of excess costs of the program which translated to fees to borrowers and lenders. You are correct.

Chairman MANZULLO. So it is a tax. It is more money that has to be paid.

Mr. WALTER. It is funds that were appropriated or paid by borrowers and lenders that were not needed to cover the costs of the program.

Chairman MANZULLO. Okay. So we agree on that, so my question is if there has been an excess of $525 million in fees, then why does the budget want to increase the cost of loans including disaster loans and charge a fee for giving advice at the SBDC? I know this is not your budget. If you say you do not know, I could accept that.

Mr. WALTER. I can give you an answer to that.

Chairman MANZULLO. Go ahead.

Mr. WALTER. The funds that you see being returned to the Treasury cannot be used to offset the current year's appropriation, so we cannot use one to offset the other. They are considered to be independent decisions and independent analysis.

Chairman MANZULLO. Well, that is a budgeteer's answer. How about a businessman's answer? This is the Small Business Administration.

Mr. WALTER. What you all are all saying, I think we believe, is that the modeling process that had been used previously while it was a valid and a sound process to look at the long-term costs of loans should be revisited because of what we are seeing as actual results today. That information says that the estimations done in the past have been overly conservative.

Chairman MANZULLO. Okay. I can understand that and I appreciate that——

Mr. WHITMORE. Mr. Chairman, if I could add——

Chairman MANZULLO. Yes?

Mr. WHITMORE. We have spoken to OMB a number of times on this and we have agreement from them to revisit this area and——

Chairman MANZULLO. Maybe we should bring somebody from OMB here. I mean, I do not like the word "revisit" or "take a look at." You know, you have one shot in this world to make a sale. If you do not sell a hamburger the first time, that is a lost sale. That is the way businesses work and we would anticipate that at least it could work the same way.

And, John, I know your frustration with the OMB, but if we have another hearing on this, we can bring them in here and let them do their loop de loop as to why $525 million of small businessmen's money is going into the general pot and why the small businessperson has overpaid and now he is being asked to pay again. I think it is grossly unfair. I think it is totally incompetent.

I look at it—here is $150,000 to $700,000 one-time fee goes from 3 percent to 3.5 percent, that is a half percent increase and on a $200,000 loan, the fee goes from $6,000 to $7,000, but the ongoing fee increases from .5 percent to .8875 percent. That means a present balance on a $200,000 loan goes from $1,000 a year to $1,775 a year.

I mean, I am scratching my head trying to figure out what we are doing here, when these small businesspeople who have gotten these loans have paid in excess in the last two years alone of $525 million and now they are facing increases.

Do you have a response to that?

Mr. WHITMORE. Well, I think the response is as Greg just said, that the cycle of evaluation of the subsidy rate is a long-term evaluation to try to take in a full economic cycle. A lot of people believe that is pretty conservative and it should be re-looked at. We have talked to OMB about it. I know revisiting is not the word you want to hear, but——

Chairman MANZULLO. Would you give me your answer on it? Give me your gut instincts. You are a businessperson.

Mr. WHITMORE. It seems that we have collected more fees in the past than need be.

Chairman MANZULLO. Okay. I appreciate that.

Ms. VELÁZQUEZ. Mr. Chairman?

Chairman MANZULLO. Do you want to——

Ms. VELÁZQUEZ. Yes. Would you please yield?

Chairman MANZULLO. Of course.

Ms. VELÁZQUEZ. When are you going to do it? You said that you are going to revisit it. Last year, the administration was here testifying on the budget, the same issue was raised, so you tell me when are you going to deal with this issue once and for all?

Mr. WHITMORE. Madam Ranking Member, we have a new administration and a new administrator coming and we have every reason to believe this will be revisited in late summer and we will see some changes.

Chairman MANZULLO. Good. What we will do is we will have a hearing on it then and then perhaps Ms. Velázquez and I can sit down with the new SBA administrator and give him our input on it and we could take it from there.

I have one question that is unrelated. Mr. Whitmore, it is totally unrelated, but, as you know, I am interested in improving and enhancing the Office of Advocacy and one provision in my draft bill would fold the Office of the Ombudsman into the Office of Advocacy. I would like to have your opinion of this idea.

Mr. WHITMORE. I really cannot give you an opinion at this particular point. We are discussing it with OMB, again, and also it will be discussed with the new administrator once confirmed.

Chairman MANZULLO. That is fair.

Mr. WHITMORE. I think the ombudsman office is a very valuable office and I think it does an awful lot of good, but whether it should move or not, I would ask that you wait until a new administrator is confirmed.

Chairman MANZULLO. Okay. I appreciate that.

Mr. Pascrell.

Mr. PASCRELL. Mr. Chairman, on the way over to vote, you may say get a life, I read your opening statement, Mr. Chairman. I found it very, very interesting because the things that you disagree with I think most of us disagree with, but there is a basic problem here. Both sides should understand what the basic problem is and if I repeat myself, I apologize. We are trying to squeeze a gallon and a half out of milk into a pint bottle. It is not going to work.

We are talking here with the messengers. And all due respect, these are two good people who have good public service behind them and they have been asked to come before us to sort of justify what is happening here.

And most of the people on the other side of the aisle—look. All my legislation I have introduced is bipartisan. I take a back seat to no one. But you all voted for a budget that puts every issue on the line, including small business. You cannot do it. You cannot have it both ways.

You cannot say you are out to help the small business folks and then accept a budget that cuts what we are able to do by 43 percent. You put the public officials on the line, on the spot, and it is an unfair group of questions. It is like me asking, Mr. Whitmore, can you live within this budget, that is like asking the question when did you stop beating your wife. It is an unfair question and I am not going to do that.

I have looked at the budget very, very carefully and this is going to be repeated throughout the Hill over the next few weeks, not just in small business. Well, you will have to learn to live with it. Well, I guess we will. Whatever the numbers are, the numbers are. Unless they are changed in appropriations. We have not seen that scene yet, that drama yet.

Even though this administration acknowledges that small businesses will have trouble accessing private capital in the absence of a government guarantee, it still does not want to subsidize the cost of borrowing. That is the bottom line. The Bush administration wants the tax cut, yet the change to the 7(a) loan program effectively levies a tax.

You can call it a fee, I am going to call it a tax.

It levies a tax on small businesses that use the program and it demonstrates specifically what the numbers are. And this tax will cost the average small business an additional $1,400 in up front fees, just what they need at this point in the history of mankind in the United States. Just what the doctor ordered. And this will be justified.

Recent changes contained in the budget and the reauthorization bills that were adopted on the closing day of the 106th Congress provide an interesting comparison. One of the changes included a simplified loan guarantee fee structure which replaced the complicated tiered structure which was in place since 1995. Guarantee fees are paid by the SBA by lenders, but the cost is commonly passed on to the borrowers. Remember, this was done in the closing days of the 106th Congress. The guarantee fee structure was amended in January of 2001. So you heard the chairman talk about loans of $150,000 or less, the guarantee fee is 2 percent of the guaranteed portion, for loans greater than $150,000, up to and including $700,000, the guarantee fee is 3 percent of the guaranteed portion and for loans greater than $700,000, which there are some of, the guarantee fee is 3.5.

Now, what is being proposed in the new budget? What are the changes that we are saying we need now even though we just did what went into effect in January of this year?

Let us go back to those loans of $150,000 or less, there will be no change in the guarantee fee as I understand what is proposed.

On loans of $150,000 to $700,000, the guarantee fee will go up 16.6 percent.

The wrong people are in jail. What are we doing here?

And loans of $700,000 to $2 million, the fee will increase by 14.3 percent.

The annual loan servicing fee that lenders pay to the SBA would rise 50 base points. This is a 66 percent increase.

The Small Business Development Centers which provide management and technical assistance services to small business clients are going to receive far less money than they received last year and this year.

After the first initial hour, the estimated costs will be $10.75 an hour. Right now, that is not even charged. Now, that may not seem like a lot of money. To people who are sustaining themselves and to people who are trying to make ends meet in a tough economy where new forces are impacting upon our daily lives like energy, that is a minor issue cost-wise, cost increases, and on top of that, we are going to tax small businesses, this business friendly administration.

Now, you tell me, Mr. Whitmore, what I am missing unless I have described accurately what is at hand.

Mr. WHITMORE. I think certainly your depiction of the fees and what the changes are is accurate. I would say with respect to the Small Business Development Centers, they are currently charging very similar fees right now on all training that is being done. In fact, a number of them they charge a fee on training new businesses before they start counseling. So it is not something new to the Small Business Development Centers. It is certainly a proposal that has been put in the budget for many years. I think it is very modest this year, compared to previous years.

Right now, in some Small Business Development Centers a new client coming in, a start-up business client coming in, would be charged the equivalent of what we are proposing to take a training course even prior to starting counseling. So this is not a brand new thing for either the SBDCs or for SBA to do.

Ms. VELÁZQUEZ. Would you yield on that answer, please?

Mr. PASCRELL. Go ahead.

Ms. VELÁZQUEZ. Mr. Whitmore, can you please tell the committee which SBDC is currently doing this and the total number of SBDCs that are charging fees?

Mr. WHITMORE. There are four that required charge——

Ms. VELÁZQUEZ. On the start-ups.

Mr. WHITMORE. Yes.

Ms. VELÁZQUEZ. On the start-ups.

Mr. WHITMORE. Right. Fee-based training required for pre-counseling. There are four that require it and I would say there are eight to twelve, that encourage fees to be charged.

Ms. VELÁZQUEZ. Twelve?

Mr. WHITMORE. Well, I can count them, if you would like.

Ms. VELÁZQUEZ. Twelve? So——

Mr. WHITMORE. It is not all, but some do it already.

Ms. VELÁZQUEZ. Sir, out of a thousand?

Mr. WHITMORE. No, out of the lead centers.

Mr. PASCRELL. Mr. Chairman, if I may conclude?

This dilemma mirrors the president's proposals. It is a dilemma which will be heard in many rooms similar to this throughout the Hill. You cannot have it both ways.

So therefore I have come to this conclusion, Mr. Chairman, we should accept and support the 43 percent cut in small business and let the cards fall where they may. Would you agree with that? What other choice do we have?

Mr. BARTLETT [presiding]. I think it is the purpose of the hearing to determine the facts and then when we have all the facts on the table we will deal with it.

Mr. PASCRELL. No, I am sorry, Mr. Chairman, that is not acceptable to me because you cannot have it both ways. You vote for a budget that puts us in a shoe box. With all due respect, you put us in a shoe box and then you are telling us to ask questions to these panelists who are simply here to carry the message. It does not work that way. We are being made fools of, to think that we could change what is already out there, unless we are going to make the pint bottle larger through the appropriations. That is not necessarily unheard of either, is it?

Mr. Chairman, this is a fraud. Thank you.

Mr. BARTLETT. Mr. DeMint would like to make a very brief comment and then we will go to Mr. Issa.

Mr. DEMINT. Thank you, Mr. Chairman.

Mr. Whitmore, appreciate you appearing here and taking the heat. You mentioned in your testimony, and I do apologize for being late, that you need to look at streamlining the agency, with changes in budget, changes with situations in the market, perhaps allowing private sector administration, more oversight.

Is there work going on within the agency to effectively restructure long-term strategic plans that look at how you are operating? Is this something that is going on now that we can look forward to a different way to deliver services and even upgrade services?

Mr. WHITMORE. Yes, sir. We are looking at virtually all our programs in all areas to make sure that they meet the needs of small business in the 21st century. Certainly electronic commerce has changed everything and how fast we can deliver information is very important. We are making detailed recommendations in each of the program areas that we intend to give to the new administrator once confirmed and I assume that some decisions to change program areas and restructure and streamline the agency will take place.

Mr. DEMINT. Thank you.

Thank you, Mr. Chairman. I will yield back.

Mr. BARTLETT. Thank you.

Mr. Issa.

Mr. ISSA. Thank you, Mr. Chairman.

I will be brief, but I am going to follow a pattern that you might find, Mr. Whitmore, very reminiscent of your previous—I will say inquisitors because I think that is why we are here today. We do realize that you are in an interim position and I appreciate your understanding that you are getting combat pay, we are going to make sure that happens.

The first point, would you put back up Ms. Velázquez's poster that was taken down?

And I am new to Congress, I have been here 140 days, but I spent 20 years as a small——

Pardon me? Just put that one back up.

I was in business for a long time and in 20 years, in every one of those years I would have shot a messenger that tried to tell me that there was a steep decline or there was less need and chose a peak year that looks like that. So if there is one message you take back from both sides of the aisle, it is do not try to use a convenient statistic on this body. We get enough of them and when we find them coming from the other side of the aisle or from this side of the aisle we do not like them, but we cannot tolerate them coming from an administration.

We need the facts in as an honest a way as you can so that we can make appropriate decisions on budgets and on other areas. No question there.

I do have one question and that is that if this body were to work with the body of the whole and create the ability for funds to not go back into the general fund, as is so often our tradition, but to remain within your organization, would you consider that, based on your tenure, to be something that you would look forward to?

Mr. WHITMORE. I think that would be very viable.

Mr. ISSA. Okay. The next question, I will put you back on the hot seat. You mentioned somewhat in passing that in the latter days of the last administration, November and December, 70 to 80 slots were filled. Can you tell us a little bit more about that?

Mr. WHITMORE. Well, there was hiring right at the end of the last administration. I am not sure that most of those were not going to the areas that we thought were most in need and that is portfolio oversight, especially in the changing times, we are very concerned with that.

Seventy additional hires at SBA is very difficult to deal with. We are a very small agency. The turnover rate is roughly maybe 150 positions a year. We have been going down in terms of size over the years and so that really handicaps the next administrator.

Mr. ISSA. Would it be fair to say that this administration was set up somewhat deliberately by the outgoing administration?

Mr. WHITMORE. I think the new administrator is going to have difficulty as a result of those recent hires at the end of the year.

Mr. ISSA. I appreciate that. The one thing that I would also pass on, again, not as a congressman as much as somebody who spent a long time in business, this subject of the fees perhaps being raised when they should be lowered, being poorly calculated based on historic events. I will remind you of the story of the outgoing CEO and the incoming CEO and when the outgoing CEO hands the incoming CEO envelopes and he says, “Any time you get in trouble open one of these envelopes.”

And the first one, the very first one, when the CEO gets in trouble, he opens it and it says “Blame your predecessor.”

You only have one chance to do that, you only have one chance to say that work done in the previous administration might have been in light of new facts misguided. I suggest strongly that your administration prepare the way for the new administrator to open that envelope and reconsider the historic way that these were calculated to get to this body a more accurate calculation based on your own reports.

Just for everyone else, of course, the next two are "Reorganize." I would suggest that the new administrator, if he is going to do, open both at the same time.

And the last one, if you do not do those two well and you come back to this body again year after year with the same problems, the last of the three envelopes says "Write three letters and put them in envelopes."

So let us recognize that you really only get this one chance for change.

The last point I have, and it is one of deep concern, I believe the microloans which have worked so well around the world and they are targeted and they are intended to be expendable if they need to be, but they have proven to be paid back in huge amounts, area an area that I would like to see year after year your proposals come back with more funding for that, more availability and more emphasis and your own statements that the quantity is going down, albeit a little debatable based on base year, but the dollar figure is going up, to me as somebody who spent my entire business career as a small business man is a bad sign.

When I got to $100 million, yes, I could have gotten a small business loan, but, no, I no longer needed one. But when I had $7,000 and a 1967 Carmen Ghia, that is when I had a dream and should have gotten the kind of attention that I hope you will be giving.

I yield back the balance of my time.

Mr. WHITMORE. Mr. Chairman, if I may respond, the 1995 year I selected. It was not done by the administration and we selected it solely as the high year when we walked through this. It was not to pick off any other thing.

What we were trying to highlight here is not so much that we were going from the high year down, but for certain segments of the community that want loans we are seeing a flat trend more than anything else. It was definitely high in 1995, but we are saying in certain areas, the percent of dollars and the percent of loans going to African-Americans or Hispanic-Americans, should be on the up rise and we are not seeing that trend. And that is the reason we picked 1995. I made the selection of 1995, it was Administration.

Mr. ISSA. Well, I appreciate that. And, of course, year after year, if we continue to use five years, we would accept that the anomaly would be reasonable, if that is always the case.

Mr. WHITMORE. We just picked a year that went back and certainly that was a high year.

Mr. ISSA. Thank you.

Ms. VELÁZQUEZ. Would you yield on that?

Mr. ISSA. Yes, I would yield.

Ms. VELÁZQUEZ. Did you check on 1992 and see the number of loans for Hispanics?

Mr. WHITMORE. We did look at the loans all the way back and we just picked a year and I made the selection on that.

Mr. BARTLETT. Thank you very much.

Now we will turn to Mr. Gonzalez.

Mr. GONZALEZ. Thank you very much, Mr. Chairman.

I want to cover policy and then its application and I am looking at your statement on page 1, "The proliferation of new programs at the SBA has come at a cost of diluted focus and lack of attention to our bread and butter programs. * * * We are concerned that neither our programs nor our delivery structure are ready to serve small business needs in 2002 and beyond."

My understanding of your strategy and that of the administration is to try to have some of these programs where you already have fees to increase fees, where you do not have fees, create fees and they become self-sustaining and non-subsidized. I think that is the basic approach.

Did you all consider, and I know we have covered it more or less, but I want to know in process, did you all consider how that would impact the utilization of any of these programs?

In other words, reduced opportunity for individuals to take advantage of the programs and, of course, then the result of that in your projections in what fees you think they would be generating. And then I will have a follow-up question and apply it to a local entity.

Mr. WHITMORE. A demand study was not done in the 7(a) loan program, but we did look at it from the sense that we wanted to ensure that the majority of loans be $150,000 or less. I believe it is 60-some-odd percent. And they would not be impacted by fees at all.

On a large loan, a $1 million loan, for instance, it would amount to $42 a month additional cost to the borrower. It is still an additional cost, but we did not think that that would really slow down demand for the program in the larger loan areas.

Mr. GONZALEZ. And on fees for counseling, did you think that might impact the availability to individuals seeking the services of the Small Business Development Centers?

Mr. WHITMORE. As I said earlier, some already charge training fees in that same range and it does not seem to——

Ms. VELÁZQUEZ. Just ten.

Mr. WHITMORE. No, they all charge training fees.

Mr. GONZALEZ. Training fees in other programs, but counseling which you are proposing after the first free hour would be about $10.75 per hour?

Mr. WHITMORE. We thought that over the course of a year that $44 would not affect demand.

Mr. GONZALEZ. Did you consult the Small Business Development Centers on that policy?

Mr. WHITMORE. We did not consult them until after the budget was developed.

Mr. GONZALEZ. Because it would seem to me that maybe before you propose that, that maybe you would go straight to the individuals on the ground and say: "Hey, do you think this would have any kind of negative consequence?"

Mr. WHITMORE. We have proposed fees for probably 10 to 15 years and we have gone through this same situation. The fee proposals in the past were considerably higher. We thought this was pretty reasonable at $44. A recent study that was done by the SBDCs indicated the businesses they counseled, I guess at 55 of the centers, had over $5.3 billion in revenues. That was based on, I think, a 1999 study that SBDCs had commissioned. So we thought that some of the businesses and the SBDCs themselves say quite a few of their businesses are more seasoned businesses and we did not think that a $44 cost over the course of a year would impact demand.

Mr. GONZALEZ. Okay. But we are talking about the first hour being free and thereafter—regardless, I mean, we are not saying big, small, medium size, we are talking everybody, right?

Mr. WHITMORE. Right. We are.

Mr. GONZALEZ. And I think that is a real important distinction. And then so I bring it down to my Small Business Development Center in San Antonio which is something that is truly treasured, and that is the University of Texas at San Antonio, Small Business Development Center, it covers 79 counties, 108,000 square miles, a population of nearly 6 million people and about 108,000 businesses and they do a tremendous, tremendous job. And the director received a letter from the SBA and in it it states "Please ensure that your budget proposal has an additional column for the proposed fees for the counseling portion of the funding" and in the request for their budget, it indicates that a federal dollar amount not to exceed *x* amount and it says and a program income amount of $246,135.

My question to you is I guess you are asking these directors to incorporate what they perceive or anticipate that they would be collecting under this fee structure. Is that correct?

Mr. WHITMORE. Yes. That letter has caused some confusion. I was made aware of it yesterday. I think it tried to indicate that this is what the budget proposal is. We have also indicated in there that it is subject to the final appropriation as well. But we will send a letter out today to every SBDC to clarify that.

Mr. GONZALEZ. But they still will be required basically to indicate their anticipated fee structure and what they would be bringing in if there was a $10.75 per hour counseling fee after the first free hour.

Mr. WHITMORE. When we send this particular letter out, we do not know what the final numbers are, so it is usually estimated. When we know what the budget number actually is, the SBDCs would come with adjustments. But we will send a letter out this afternoon that will clarify that.

Mr. GONZALEZ. And, Mr. Chairman, I seek your indulgence, one last part——

Mr. WHITMORE. May I mention one last thing, Mr. Congressman?

Mr. GONZALEZ. Sure. Yes, sir.

Mr. WHITMORE. In San Antonio, that is one of the SBDCs that does encourage fees on new businesses before they start counseling. It is encouraged, it is not required.

Mr. GONZALEZ. And have you talked to the director regarding your proposed fee on counseling after the first free hour? Because I do not think you will have—let us just move beyond that.

Let us say they do not meet—they have the projection, they provide it in the budget, you adopt it and they are going to come up with *x* amount of dollars in fees.

Now, contrary to what you all thought, it does impact the number people utilizing the program and they come up short on the fees that they are collecting. What is the consequence to the center?

Mr. WHITMORE. If they do not raise the fees?

Mr. GONZALEZ. I am just saying as you all go through with this, they are going to have projections on what they anticipate, because I am sure you are not asking that for no reason. But they do not meet those because you all were wrong. You all were wrong because it did impact the number of people, especially in south Texas, $10.75 on counseling is—I will tell you, that will impact the program. So let us just say you have fewer numbers of people utilizing the program, therefore you do not have the fees that you anticipated collecting on this counseling fee arrangement, so they are not meeting that particular projected budget amount. What is the impact to the center?

Mr. WHITMORE. I assume the impact would be very similar to when they establish their own budget, they include fees when they are doing their own budget projection. They include fees from what they anticipate they would take in from training, so I assume they would view it the same way.

If they do not make their fees, they probably would have to limit the amount of time they are open or the amount of services given. But in their own budget projections, I assume they include fees that they raise themselves through training as well as what they anticipate getting from the matching funds required for our program, either through state or private entities.

Mr. GONZALEZ. All right. Thank you very much.

Thank you, Mr. Chairman.

Mr. BARTLETT. Thank you.

Mr. Grucci.

Mr. GRUCCI. I have some questions but will you pass me for a moment.

Mr. BARTLETT. Yes, sir. I would be happy to.

Ms. Millender-McDonald.

Ms. MILLENDER-MCDONALD. Thank you, Mr. Chairman. And may I first ask unanimous consent to submit my statement for the record?

Mr. BARTLETT. Without objection.

Ms. MILLENDER-MCDONALD. Thank you so much.

I am really distressed, Mr. Whitmore. I suppose the person who spoke a couple of speakers before stated that you are the messenger, you are not the one really we should be driving this wedge to or through, but I am really concerned about the seriousness of this budget. This is an assault on the Small Business Administration. It certainly does not do well for those who are trying to increase economic viability in low income areas, urban areas, rural areas, for those who small businesses have created the jobs for and especially women-owned business.

As I look at your 7(a) program, there are decreases for veterans as well as for women. This does not fit well in communities which I serve, Watts and Compton, some of the most impoverished areas, because they are looking to small business to help them in microloan programs, as Mr. Issa said, that you really need to revisit that microloan program and do open the envelope or put something in the envelope yourself to revisit these programs that are just so important to urban and rural areas.

I could shout at you, but you are just the messenger, but please report back to the person down on 1600 Pennsylvania Avenue that we do want to see not increase in fees, decreases in programs that help those who are distressed and in distressed areas, but let us revisit this budget and look at where we can improve the funding base and try to minimize the fees because it is critical for those who are trying to create jobs, especially in my district and I suppose for all of us who represent urban and rural districts.

And that is it, Mr. Chairman. Thank you so much.

Mr. BARTLETT. Thank you very much.

Now Mr. Grucci.

Mr. GRUCCI. Thank you, Mr. Chairman.

I have a couple of concerns and they are on both sides of the issues that we are dealing with today, certainly on the SBDC and the 7(a) program. I have an SBDC shop in my district, it is at the University of Stoneybrook and it does wonderful work and it has done a lot of good to help a lot of small businesses get underway. And they are very fearful of the fee schedule that is now being imposed.

And I just want to ask you a question on that. You have indicated a fee of about $44 a year. I would have to assume that that means the first hour being free that you are thinking about four hours worth of counseling at the rate that I am looking at, you get about four hours worth of counseling at $44 and that is enough for a small business entrepreneur with no experience in the business community, no experience with running a business, four hours of counseling will be enough to satisfy their knowledge of running a business.

I would have to see that statistic to really appreciate it being accurate. I mean, I know that—we have a small business and it requires a great deal more counseling by our professionals than four hours a year. I would welcome just four hours of counseling to help us through some of the mazes of getting through the bureaucracy that exists for small businesses. And so I question that fee.

And the fear that our SBDCs have is that since this is both a state and a federal program you are now going to have the state jumping on board with their opportunity to create the fees because now it is going to be new monies for them as well, so now you do not have a $10 an hour or $10.75 an hour fee, you have something closer to $22 an hour that is being placed on the small business entrepreneur and my guess it would be far more than four hours worth of counseling necessary and, you know, we discourage them from coming into the business world rather than getting involved in the business world.

I really think as some of my colleagues said here today that we do need to revisit this issue. I do not think there is going to be a great deal of support for the fee structure on the SBDC programs and I know that I am speaking to the ones in my district, they are very fearful of it, they are concerned about it, and they do not think it is going to be helpful, they think it is going to be injurious, is their words.

Let me just move on to the 7(a) program for a moment. We were a recipient of the 7(a) program. My family's business suffered a very significant issue in 1983, we had a fire. I am in the firework business. It led to a series of explosions, completely wiped out the operation of the business and without the 7(a) program to be able to go to to borrow from, we would not have been able to stay in business and we needed to borrow a half a million for capital and a half a million for working line and obviously under this structure we would have been then subject to the fee schedule.

And I do not see the formula for the fee schedule anywhere, I do not know how that fee would be created, what it is based against. Is it based against the volume of dollars that you borrow? Is it based against some other formula?

All of that does not help to sustain business or to grow business. And I know when I say this I am preaching to the choir because you probably know far better than I do that the engine that drove this economy is not the Fortune 500s but the mom and pop operations that dot the Main Streets of America for Montauk Point to Monterey Bay and to that end we have to do all that we can to make it easier for them to come into these businesses, provide those jobs, provide those opportunities and what I am seeing here is not going to do that.

I think we need the funding in place, we need to reinstate the $12 million for the SBDC and we need to fund the 7(a) program while we can be assured that it can ultimately get to a zero subsidy and that it can operate independently of the subsidy.

Until that point, I am not convinced and I would certainly like to see you pay closer attention to the needs of the districts like mine and others that you heard from here today because we speak for the American small business people.

I do not know if there was a question in there or not, if you would like to respond to that, you certainly can. I feel very passionate about these two programs because I have dealt with them firsthand and I think that they are in jeopardy and being in jeopardy hurts the American business person.

Mr. WHITMORE. I would like to say a couple of things on fees on both 7(a) and on SBDC. Generally on business loans or any kind of loans, there are points charged to make the loan. So there are some points, whether it is an SBA loan or whether it is a commercial loan.

There is an increase in fees on the very large loans. We are concerned that the smaller loans are the most difficult for SBA to get made and not increasing fees on loans under $150,000 we think would be helpful to the program.

In terms of SBDCs, there is no fear in charging training fees, so I am a little confused myself on why there is a great fear in charging counseling fees. The SBDCs across the country charge fees today as we speak, they just do not charge them on counseling.

And to address the hours, I agree with you, it may very well be more. What we took was an average number of counseling hours based on the number of clients they counseled and we came up with five, the average. But if that is the average, there are some at three and there are some at 15 also.

Mr. BARTLETT. Thank you very much.

Ms. Tubbs Jones.

Ms. TUBBS JONES. Good morning, Mr. Chairman.

Mr. Whitmore, I apologize, I missed the beginning of your presentation. Will you give me very quickly your background with SBA, please?

Mr. WHITMORE. I have been with SBA since 1977. I worked primarily in the procurement and 8(a) programs. I also was the CFO of the agency at one point. It does not sound like I can keep a job very long as I am telling you this. I was the head of Management and Administration, and I worked in the Entrepreneurial Development Program as well.

Ms. TUBBS JONES. And what is the Entrepreneurial Development Program?

Mr. WHITMORE. SBA's technical assistance programs. It is the Women's Business Centers, it is the Small Business Development Centers, it is Business Information Centers, Veterans' Business Assistance Centers and SCORE. And I probably missed one.

Ms. TUBBS JONES. Thank you. In your statement, Mr. Whitmore, you began to outline what programs would no longer be funded in 2002 and as I read through each of them, it said that they are being defunded because they are duplicative or they are redundant programs.

Can you specifically tell me what program will handle the programs that BusinessLINC was put in place to provide?

Mr. WHITMORE. BusinessLINC had been in operation for two years without any funding. It is designed to foster mentor-protege relationships. SBA has 11,000 senior executive volunteers that certainly would be able to work in that area.

Ms. TUBBS JONES. That is the SCORE program?

Mr. WHITMORE. The SCORE program.

Ms. TUBBS JONES. Before——

Mr. WHITMORE. In addition, there are other——

Ms. TUBBS JONES. Hold on a second. Hold on. I only get five minutes and I know I walk on treacherous grounds when I start doing this, but I only get five minutes, so I do not want long answers. I want you to specifically address my question so I can take you to the next question, okay?

Now, particularly because you brought up SCORE, now, the people who work in SCORE are retired executives who no longer have businesses, correct?

Mr. WHITMORE. That is correct.

Ms. TUBBS JONES. Now, the purpose of BusinessLINC, however, was to take existing strong businesses, make relationships with small businesses to kind of create an old boy network, right?

Mr. WHITMORE. Yes.

Ms. TUBBS JONES. And clearly if you have BusinessLINC and an old boy network, it is much better than having somebody who is retired who has no existing business to maybe provide you the opportunity to do business, correct?

Mr. WHITMORE. I do not want to talk about the old boy network there because——

Ms. TUBBS JONES. Well, it is true. I mean, you are not offended because I am talking about old boy, but everybody—it is a concept.

Mr. WHITMORE. SCORE, I may be going there myself soon. But there are other programs. SBA has had a mentor-protege program for quite a while. The Department of Defense has a mentor-protege. I believe NASA has a mentor-protege program.

Ms. TUBBS JONES. Well, were you around when they talked about creating BusinessLINC? You have been with SBA a long time, right?

Mr. WHITMORE. I was not involved in the creation.

Ms. TUBBS JONES. You were not in that. But you have been involved in SBA and the various technical assistance programs and clearly having a mentor is a great technical assistance for any small business, correct?

Mr. WHITMORE. I certainly think it is.

Ms. TUBBS JONES. Okay. Now, I am particularly concerned about the defunding of BusinessLINC because as a result of the defunding of affirmative action programs and the lack of opportunity for minority businesses to access people who they traditionally might not get involved with, BusinessLINC was going to provide them that opportunity, to meet and greet people, because we know that much business is done on the golf course, much business is done where people have an opportunity to meet people that they traditionally would not meet under normal circumstances, correct?

Mr. WHITMORE. Correct.

Ms. TUBBS JONES. Okay. And so I am asking that you take back to the powers that be, whoever that ultimately ends up being, I want to buy into all the other statements that my colleagues have made, but to say that here we have a program, BusinessLINC is funded for this year, right?

Mr. WHITMORE. It is funded in the 2001 cycle. The performance of BusinessLINC will actually take place really in the 2002 year.

Ms. TUBBS JONES. Say that again?

Mr. WHITMORE. The awards for the BusinessLINC awards will take place later this summer.

Ms. TUBBS JONES. Okay.

Mr. WHITMORE. The performance of the BusinessLINC awards will be during the course of fiscal year 2002, starting probably in October of next year.

Ms. TUBBS JONES. And before you have had a chance to really evaluate the value of such a program, you are defunding it? Is that correct?

Mr. WHITMORE. Well, it is not funded in 2002.

Ms. TUBBS JONES. Right.

Mr. WHITMORE. It will be operational——

Ms. TUBBS JONES. So then my question is that before——

Mr. WHITMORE. It will be operational in 2002.

Ms. TUBBS JONES [continuing]. You have had a chance to evaluate the success of the program, you have decided—maybe not you personally, but a decision has been made to defund the program.

Mr. WHITMORE. Yes, ma'am.

Ms. TUBBS JONES. And it appears to me that throughout all of the defunding—this is my last question, Mr. Chairman—that everything that has been called redundant are programs that the last administration trying to reach new markets, as they called them, are not being funded. Is that correct?

Mr. WHITMORE. There are two programs that were not funded, the PRIME program and BusinessLINC. The New Markets Venture Capital Program was funded according to the authorization, it was a one-time funding, it was not defunded, the authorization was for a one-time funding.

Ms. TUBBS JONES. Well, if I am a program, whether I am defunded or not reauthorized, it is the same effect, though, right?

Mr. WHITMORE. The effect is the New Market Program is going to last for five or six years. It is intended to fund up to $150 million in venture capital and it was funded for the term of its authorization.

Ms. TUBBS JONES. I do not know if you answered my question, but I am not going to belabor the point.

Mr. Chairman, are we going to get another chance to make inquiry?

Mr. BARTLETT. We can have a second round if the members wish. We will have another panel and opportunity to question them.

Ms. TUBBS JONES. Thank you.

Chairman MANZULLO. Thank you very much.

Mr. Udall.

Mr. UDALL. Thank you, Mr. Chairman.

I come from a district, Mr. Whitmore, that has a number of small businesses and small businesses accounted for nearly 90 percent of all new net jobs in my state last year—80 to 85 percent of those jobs were created by businesses with ten or fewer employees. I also have a large Native American population and New Mexico is one of the states that has a very high utilization of SBDCs.

I have heard you talk here and heard you try to explain this, but I am really not happy with this proposal to charge fees for SBDCs and I wanted to ask a couple of questions in that area and also possibly follow up on what Ms. Tubbs Jones talked about in terms of the mentoring program.

For 2001, SBA requested $4.5 million for the Native American outreach program. Of that, $1.5 million was to fund 18 existing Tribal Business Information Centers, upgrade the technology infrastructure and to provide additional business development training and technical assistance to Native American customers.

The remaining $3 million was to establish reservation-based Native American Small Business Development Centers to provide business development assistance, counseling, training and other services to Native Americans who want to start, maintain and grow businesses.

My question is being that the SBA never received the funding for Native American outreach or the TBICs, how has SBA been able to assure the proper operation and success of the program?

Mr. WHITMORE. With regard to the Tribal Business Information Centers, we have been funding them out of the SBA's operating budget. I will tell you the funding is roughly around maybe $30,000–$33,000 per TBIC. That is basically to fund somebody, usually from the tribal community college, to work there. We are looking at that area very seriously. It did not get funded, as you know, last year. We do not anticipate taking funding away from it at this point. However, we do think that we are not seeing the productivity out of the Tribal Business Information Centers that we would like to see. We are not seeing economic development out of there.

With respect to the SBDCs, there is no prohibition by the SBDCs right now under the current statute and their current funding to opening subcenters on Native American reservations. Certainly it would always be nice to get additional funding, but we would question why they are not open on reservations today with the current funding. There are 900 centers, we have very few, if any, on reservations.

Mr. UDALL. In your experience with the SBA, do you see a need out there in terms of the Native American community?

Mr. WHITMORE. I think that that is probably the most under served community in the United States, especially reservation-based Native Americans.

Mr. UDALL. And you realize, I think, in saying that, from your experience, that some of the reservations have unemployment of 50 and 60 and sometimes 75 percent and so this kind of a program obviously is very, very important to Native American communities and when you say we are not seeing the economic developing out there, I would hope that your agency would try to look at creative ways and come back and talk to us about how we can see small business growth out on the reservation because this is a dire need and I would hope that you would try to focus on that. If something you have in place now is not working, then come back and give us some suggestions on that.

Mr. WHITMORE. Mr. Congressman, we talk about funding our core programs. We think our core programs should meet the needs of all small business and all Americans. Certainly the 7(a) program and the SBDC program should be able to deal with Native American problems and economic development and we have not seen that and we think we need to focus and manage in those two areas. I am sure the new administrator is going to take a look at this area and if we have ideas that are a little different, we certainly would come up here and propose them.

Mr. UDALL. Thank you very much, Mr. Whitmore.

And thank you, Mr. Chairman.

Mr. BARTLETT. Thank you very much.

Dr. Christian-Christensen.

Mrs. CHRISTIAN-CHRISTENSEN. Thank you, Mr. Chairman. I apologize for being here late but I am glad I had a chance to get here before Mr. Whitmore has left.

And I am sure you have heard a lot from this committee and the dissatisfaction with the proposed budget for SBA. I want to focus, though, on the disaster loan area because over the past two years SBA has begun to conduct asset sales and some of those sales have included disaster loans.

Can you tell the committee if SBA has conducted a study or done any research on the impact of those asset sales on small businesses, the small businesses that receive loans through the disaster loan program?

Mr. WHITMORE. I am not aware that we have conducted any study.

Mrs. CHRISTIAN-CHRISTENSEN. We are having problems in my district with some of those loans. I would imagine that we are not the only jurisdiction that is experiencing those problems. Has there been any follow-up at all on what has happened since those sales?

Mr. WHITMORE. I cannot answer that. I would be happy to submit an answer for the record on that. I am not sure.

Mrs. CHRISTIAN-CHRISTENSEN. Okay. Then, Mr. Chairman, I would ask that we have that submitted in writing to us. Thank you.

Let me just go a little further into this. When the sales first began to take place and we started to receive complaints from my community, we called officials from SBA who oversee the disaster loans and we were really assured that the terms of the loans would not change and even the administration of those loans would not change.

Now, in my district, we have had several major hurricanes and businesses have secured loans to rebuild their business in one season and then been faced in another subsequent season with a similar disaster and had to take out another loan, and this despite a lot of work being done on really mitigating for these kind of disasters. We are getting better, but still some have had two subsequent loans. And now they are being asked by the banks to repay their outstanding balance.

Have you heard any——

Mr. WHITMORE. The asset sale program is required of SBA. I have only been there since February in an acting capacity and have not received any feedback on the subject. I am unaware of any reason that any of the terms and conditions of those loans should change unless it would affect their ability for future borrowing. They should not change the terms and conditions just because the loan is sold.

It may affect someone's ability, ma'am, to get an additional loan if they have outstanding balances.

Mrs. CHRISTIAN-CHRISTENSEN. Yes.

Mr. WHITMORE. Where we may have some issues there, but it should not come from the purchaser of the asset sales, it would be coming from the SBA disaster assistance office, if they had questions regarding the cash flow of the business or the homeowner.

Mrs. CHRISTIAN-CHRISTENSEN. Well, we would like to follow up on this issue with the administration because it may not be specifically so much the terms of the loan, but there were certain things in the operation of that program that borrowers traditionally could expect when dealing with SBA that does not occur now with the banks having bought those loans and it is creating a hardship in my district.

Mr. WHITMORE. Those that have purchased the loans have been fairly cooperative in working with borrowers when they have run into financial difficulty, but I really am not versed in this area and I would be happy to get any response to you.

Mrs. CHRISTIAN-CHRISTENSEN. We may have to ask you to help us get some response and cooperation from at least one of the banks that holds most of the home loans and most of the disaster loans in my district.

Thank you, Mr. Chairman.

Mr. BARTLETT. Thank you very much.

I want to thank the witness and the members of the committee. When I chair a hearing I usually reserve my questions until the last and I will recognize our ranking member in just a moment.

With the anticipation that most of the questions that I would have asked will be asked by someone else and that has certainly been true today, everything has been said pretty much, I think, and I do not need to repeat it.

I would just ask Mr. Whitmore if he has gotten the message that this is a truly bipartisan committee that is concerned with the small business community.

Mr. WHITMORE. Without a doubt.

Mr. BARTLETT. That message is loud and clear. Okay. We speak, I think, with a unified voice on this committee. We are concerned for the small business community.

I am one of probably 35 more or less people who came to this Congress from an FIB. I was in small business before I came here. Too few of us have been there. And so I am very appreciative of the really good attendance at this hearing today by our subcommittee members and thank you for your testimony.

Let me turn now before we convene the next panel to our ranking member.

Ms. VELÁZQUEZ. I really appreciate it, Mr. Chairman.

Mr. Whitmore, in your testimony you state that the objectives of the New Market Venture Capital Program can be achieved more efficiently and at a lower cost to other means. You also state that the programs that provide direct investment into economically distressed areas already exist. What other program is there provides a combination of equity investment and technical assistance?

Mr. WHITMORE. Well, the Small Business Investment Company Program invests a substantial number in low and moderate income areas——

Ms. VELÁZQUEZ. Sir, I am asking you a combination of equity investment and technical assistance.

Mr. WHITMORE. Certainly those receiving the SBIC investment would be eligible to get SBDC assistance or SCORE assistance, but we do not have a program that has those in combination.

Ms. VELÁZQUEZ. So then how could you come before our committee and state that equity investment can be achieved through other programs that already exist?

Mr. WHITMORE. We think the New Market Venture program will be run over the next five or six years. We are not saying that it is being eliminated, there was just not additional funding. The program was authorized for a one-time funding and received that one-time funding.

Ms. VELÁZQUEZ. Targeting low and moderate income communities.

Mr. WHITMORE. Absolutely. Yes. And we expect the final rule for that program to be published probably tomorrow or the next day.

Ms. VELÁZQUEZ. I said in my opening statement that it seems to be a disconnect between the White House and what is going on in terms of our economy and the small business community. Does the administration understand the importance of technical assistance when it comes to investing in low income areas?

Mr. WHITMORE. I think they do. They support the New Market Venture program this year——

Ms. VELÁZQUEZ. You are telling me that, yes, they do, but the administration insists on eliminating the new market's and PRIME technical assistance components while at the same time funding for the microloan technical assistance program has been done just at one-third of its authorized amount. Is that not correct?

Mr. WHITMORE. That is correct. At $20 million.

Ms. VELÁZQUEZ. So can you tell me where will the technical assistance come from that the new markets is supposedly duplicating?

Mr. WHITMORE. I think it should come from our existing programs. I think our focus on our existing programs should ensure that we serve all Americans. SCORE, SBDC, 7(a), the Women's Business Centers, we need to broaden the reach and manage our current programs to ensure that this kind of service gets to all Americans.

Ms. VELÁZQUEZ. You state earlier that the funding for the new markets program was intended to be a one-time appropriation. I was the author of that bill and I can tell you that that was not my intent. There have been different interpretations of the language including from the speaker's office. Can you explain that?

Mr. WHITMORE. The report language, talks about a one-time funding. And also in a press release that you issued last May indicating, Madam Ranking Member, that it was a one-time appropriation of $45 million.

Ms. VELÁZQUEZ. Not for the technical assistance component of that.

Mr. WHITMORE. It was a combination of both technical assistance and investment. Both the technical assistance program and new markets is a five-year funded program.

Ms. VELÁZQUEZ. That is a five-year program? GAPP?

So let me just say this to you, Mr. Whitmore, I am not satisfied with that answer. The new market was a commitment that we got from the White House, from Speaker Hastert, from Jim Talent, J.C. Watts, and you are going to tell me that now that the face of small business in America is changing where we have more women and more Latinos and more blacks and it is proven that technical assistance is an important component to help those who want to start up a business, you are going to come here and tell me that the New Market Venture Capital Program is not important because some of that technical assistance is being provided through other programs that you recognize have been either zeroed out or their funding has been decreased?

Mr. WHITMORE. Madam Ranking Member, specifically with the New Market Venture Capital, it is a five-year program and it is not zeroed out, it was a one-time funding of $45 million to encompass $150 million in debenture or an investment in the rest. So we are not saying it is not being emphasized. It is going to be run over a five-year period, longer on the investment side, and certainly we will have ample time to evaluate that as we go.

Ms. VELÁZQUEZ. So then explain to me what about the expenses to administer the program? If SBA does not request funds to administer the program, how will those expenses be covered?

Mr. WHITMORE. We have hired four people so far in the New Markets Venture Capital area to work on that specific area. We have a division within that area that will do the oversight and examinations already existing, but we have added four people to the New Market Venture Capital.

Ms. VELÁZQUEZ. I just want to ask you how do you think any company will want to make investment in any low or moderate income communities when the same administration is telling us that you wish to eliminate the program?

Mr. WHITMORE. In our SBIC, they are investing in low and moderate income areas now and we are not eliminating that program. And we did not say we were eliminating——

Ms. VELÁZQUEZ. Have you seen the numbers?

Mr. WHITMORE. Yes, I have. I believe it was $700 million last year. The New Market Venture program, is just starting. The first year will be in 2002, the debentures, I believe, will go over a seven-year period and the technical assistance is over a five-year period. So I think we will have ample opportunity to assess whether that program is operational and whether it actually is meeting the needs.

The most recent change we made in that program is on the regulations themselves. When the original proposal came out, I believe January 19th, it came out as an interim final rule and we redid that proposal just recently and changed a couple of the things that we felt would not be beneficial to low income areas. There was an eight-to-two investment ratio, for every eight investments you could have two investments that were not in low income areas.

We thought that would be a loophole, so what we changed that to include the money aspect, as well 80 percent of the dollars have to be invested, not just 80 percent of the loans.

Ms. VELÁZQUEZ. Do you think it will be a multi-year funding?

Mr. WHITMORE. It is multi-year funded with the one-time appropriation.

Ms. VELÁZQUEZ. Thank you, Mr. Chairman.

Chairman MANZULLO [presiding]. Thank you very much.

John, you set a record. We appreciate your stopping by. I hope you will come back again. I trust you will.

Ms. VELÁZQUEZ. Well, Mr. Chairman, I have not finished with him. I will be submitting some questions, especially on the HubZone program and the 8(a).

Chairman MANZULLO. That is okay. You will have an opportunity also, Ms. Velázquez.

And we appreciate your graciousness. Thank you for the terrific job you are doing in a very difficult position, having to defend the budget when you are the acting administrator. I appreciate your candor and coming here. Thank you very much.

The first panel is discharged. Let us have the second panel. I do not think it will take this much time.

Mr. ISSA. And, John, you look good with arrows all over yourself.

Chairman MANZULLO. Okay. If we could have Ms. Wolverton, Mr. Wilkinson, Mr. Mercer, Ms. Finch and Mr. Means. We are going to start with Ms. Wolverton.

The light in front of you is five minutes. You probably want to finish as quickly as you can. When the yellow light comes on, that means that you have one minute. When the red light comes on, that means that your five minutes are up. Some members have subcommittee meetings that start at 1:00, so I want to get this finished as soon as possible and appreciate your stopping by.

Ms. Wolverton.

STATEMENT OF DIANE WOLVERTON, STATE DIRECTOR, WYOMING SMALL BUSINESS DEVELOPMENT CENTERS

Ms. WOLVERTON. Thank you, Chairman Manzullo, Ranking Member Velázquez. I am Diane Wolverton. I am the State Director of the Wyoming Small Business Development Center. I am here today on behalf of the Association of Small Business Development Centers. I want to thank you today for extending the invitation to the Association of Small Business Development Centers to testify and for the support that you have given to the program and that I have heard even this morning.

I have given you my written testimony and I would like to offer some highlights this morning, as well as some insights into my personal experience with the Small Business Development Center.

I am a passionate advocate of the program because I am a product of it. Since the time I graduated and finished my studies in journalism, I had the dream of owning a small newspaper and that dream was realized 14 years ago when I signed the papers to buy the Bridger Valley Pioneer Newspaper in Lyman, Wyoming. And that was the beginning of an entrepreneurial adventure that was at some times exciting and sometimes perilous. I worked hard as editor and janitor of the newspaper and the business grew.

We increased circulation by more than four, we increased revenues by five times and we put people to work at a time in Wyoming when we were experiencing the oil bust and the unemployment in my county was higher than 15 percent.

Then I was an ambitious entrepreneur, as we see many of those at the SBDC, and I set my sights on purchasing the other publishing company in my town, which was the community shopper. Soon I was able to complete that deal and was busy working on my new publishing family. That is when I started to run into some trouble.

I found that I was having difficulty paying my bills on time, I found that I was struggling to make payroll and I found that very often when I was able to make payroll for my employees I was not able to take a paycheck for myself. And that is when I called the Small Business Development Center in Rock Springs, Wyoming and the counselor there helped me see that my problem was cash flow.

He gave me a visual example that was very powerful. He told me that a business is like a fish bowl. There is water coming in the top and there is water going out the bottom. My business is the fish in the middle and my job was to make sure that it does not get empty and the fish would die.

And the big aha experience was I saw that I had my sights on all the new revenues that would be coming in with my new expanded business, but I had not focused carefully enough on the new expenses that I had taken on. The Small Business Development Center helped me develop strategies that enabled me to make it through a very difficult time. They helped me solve problems to get my business back on track and eventually allowed me to sell that business for a substantial profit and it is still publishing in Lyman, Wyoming and doing very well.

Mr. Chairman, as I am before you today, it is a little embarrassing to tell you the mistakes I have made in my business, but I do it to point out the power of the Small Business Development Center and how it helps to fill in the knowledge gaps of talented entrepreneurs.

The Small Business Development Center counsellors see more than 600,000 businesses every year who are entrepreneurs like I was, that understand the basic profession or trade but the facts of business such as finance and marketing and how to deal with government regulations, they may not have total understanding of those. The SBDC plays a powerful role in filling in those gaps.

And as a woman business owner, I am also keenly aware of the need to have these services available to populations that have been disadvantaged. The SBDCs work very hard across the country to meet the needs of women and minority business owners. Last year, 43 percent, I believe, of our clients were women business owners and 31 percent minorities.

And when I started my business, I will tell you that I was recently divorced and I was reeling from the financial and emotional setback that that had brought to me and I needed that business to work, not only for the financial standing, but also to bring my confidence back, and SBDC helped me do that. And that is the power of the SBDC, it forges not only economies, but it helps to build community leaders.

We are a country that embraces the free enterprise system and it is one of the tenets upon which our country is built and I think that many people are like me that want to participate in the free enterprise system, understand parts of it, but not the whole picture, and that is what the SBDC program does effectively and it is the only national comprehensive non-academic government-sponsored program that helps our citizens participate in the free enterprise system by giving them knowledge they need.

And it is important that this program continues to be available. It is critical that it remains free. As I testified earlier, at the time I went to the SBDC, I was not even sure I could keep my lights turned on, let alone pay fees.

Chairman MANZULLO. Diane, we are at five minutes. You very emphatically and persuasively have made your point as to the value of the SBDCs. Thank you.

Ms. WOLVERTON. Okay. Thank you.

[Ms. Wolverton's statement may be found in appendix.]

Chairman MANZULLO. Our next witness is Anthony Wilkinson, the President and CEO of the National Association of Government Guaranteed Lenders.

Mr. Wilkinson.

STATEMENT OF ANTHONY R. WILKINSON, PRESIDENT AND CHIEF EXECUTIVE OFFICER, THE NATIONAL ASSOCIATION OF GOVERNMENT GUARANTEED LENDERS

Mr. WILKINSON. Good morning, Mr. Chairman, and other members of the committee.

Chairman MANZULLO. Is that clock not working in front of you?

Mr. WILKINSON. It is on.

Chairman MANZULLO. It is on?

Mr. WILKINSON. Yes, sir.

Chairman MANZULLO. Okay. All right.

Mr. WILKINSON. Thank you for the opportunity to testify today on the fiscal year 2002 budget request for the SBA 7(a) program. You have my written testimony and I would ask that it be included in the record of today's hearing.

In the fiscal year 2002 budget request, the Office of Management and Budget predicts that the subsidy budget authority for fiscal year 2001 for all SBA credit programs will be a negative $525 million, as you have up on your chart.

This means borrowers and lenders will have paid $525 million after recovering the initial appropriation provided in the various programs. The original subsidy budget authority for fiscal year 2001 was $163 million for all SBA credit programs. This will be offset by $688 million in downward program cost re-estimates, leaving $525 million subsidy budget authority profit for the Treasury.

And this is not the first year it happened. In fiscal year 2000, the subsidy budget authority was a negative $137 million and for fiscal year 1999 the subsidy budget authority was a negative $473 million. That totals $1.135 billion in just the last three years—$1.135 billion in excess fees charged users of SBA's credit programs in just three years.

Please keep in mind that this amount is after covering any initial subsidy budget authority provided to SBA's programs like 7(a) and SBIC.

Anybody who thinks that government has been subsidizing the SBA credit program users needs to look again because it is clear that it is the SBA program users who have been subsidizing the U.S. Treasury.

Specifically, for the SBA 7(a) program, the Office of Management and Budget now re-estimates that 7(a) borrowers and lenders have returned $1.257 billion to the Treasury since credit reform began in 1992. That means on average that OMB has over estimated the cost of the SBA 7(a) program by $125 million per year for ten years.

Compare the $125 million annual cost over estimate to the $118 million needed for fiscal year 2002 to fund an $11 billion program.

Even knowing all of the above, the OMB budget request asks for higher fees on SBA program users. OMB wants to supposedly drive the subsidy rate to zero so that the federal government is not subsidizing the cost of borrowing for small business.

As I have already stated, it is clear that it is the SBA program user who has been doing the subsidizing. Second, we believe the SBA 7(a) subsidy rate is already at or below zero, OMB just refuses to recognize the actual performance of the program.

For instance, OMB still requires the use of an approximate 14 percent default rate in the subsidy model. SBA officials just last year testified before this committee that the program was being managed to a loss rate of 8 to 10 percent. Using the highest default estimate per their testimony of 10 percent, the SBA 7(a) subsidy rate for fiscal year 2002 would be about a minus .29, as the subsidy rate would fall by 34 basis points for every 1 percent decrease in the default estimate. And we think defaults are actually closer to the lower end of SBA's estimates, which would drive the subsidy rate farther into negative territory.

Mr. Chairman, it is clear that small businesses have been subsidizing the U.S. Government, not the government subsidizing their borrowing costs. We at NAGGL encourage an immediate independent review of the assumptions used in the subsidy model. It is clear to us that OMB has gone well beyond the scope of the Federal Credit Reform Act. Rather than simply providing you with an estimate of the program's cost, OMB has attached a tax on program users to their cost estimates. Make no mistake about it, to a small business excess program fees are no different than a tax.

While we wait for the results of an independent review of the assumptions used by OMB, we encourage the members of this committee to support fiscal year 2002 appropriations of $118 million. This would support an $11 billion program next year. Based on the evidence we have provided, the government will get all this money back in the from of downward cost re-estimates in the future.

So please do not punish small business borrowers because the Office of Management and Budget has purposefully over estimated the cost of the 7(a) program.

Mr. Chairman, with that, I will conclude my remarks and be happy to answer questions.

[Mr. Wilkinson's statement may be found in appendix.]

Chairman MANZULLO. Thank you very much.

Mr. Mercer.

STATEMENT OF LEE W. MERCER, PRESIDENT, NATIONAL ASSOCIATION OF SMALL BUSINESS INVESTMENT COMPANIES

Mr. MERCER. Thank you, Mr. Chairman.

Ms. Velázquez, members of the committee, thank you for the opportunity to appear today to discuss the president's budget with respect to the SBIC program. I do not know whether it is a just a coincidence that I am sitting in the seat that Mr. Whitmore sat in, but I am probably the only one who is going to say that we support the president's budget, with reservations.

Chairman MANZULLO. Mr. Whitmore enjoyed it so much that he is sticking around to listen to the rest of the testimony.

Mr. MERCER. The SBIC program is in the strongest position it has ever been in right now and in great measure that is a compliment to Congress, which has, over the past five or six years, worked with the industry to completely redesign the program that was first started in 1958. The growth has been so phenomenal that the SBIC program is, I believe, the fastest growing program that SBA has in terms of financing, percentage growth, that is, and in fiscal year 2000, the program provided $5.5 billion in equity and loans to growing small businesses.

The reason we support the president's budget is that the program needs growth and the president's budget impacts the participating security program, the fasted growing part, the equity capital program. The program needs $3.5 billion in participating security leverage for fiscal year 2002 and without an increase in fees, that would require $65.5 million in appropriation or a 150 percent increase over the current appropriation in fiscal year 2001.

We believe that that is extremely difficult to achieve, if not impossible to achieve, under the current situation and even though this committee joined with the Senate committee in having money added back into the budget, it would essentially just flat fund the programs, if you will. And flat funding for the participating security program at $26.2 million in appropriations would produce just $1.4 billion in participating security leverage, far less than we need.

Increasing the fees will produce the result that the industry needs and it will create tremendous new growth and availability of equity capital for small businesses. So, the only question is can that growth be achieved through these fees in such a way that the increase in fees paid do not do any damage to the SBIC program or to the small businesses that are receiving the financing.

In this regard, this program is distinct from the 7(a) program where even though the fees increase in both programs, not every program is the same. The fee increases in the participating security program will impact only one portion of the annual rate, if you will, that participating security SBICs pay for their money.

In February of 2000, that rate for participating security leverage was 9.52 percent per year. If the president's budget were adopted today, effective today, even with the increase in fees proposed for the participating securities program, the total rate would be 8.52 percent, 1 percent less than it was a year ago. That is because the biggest driver of the rates for participating security SBICs is not the fees that paid to the government. The biggest driver is the interest rate in the market that we have to pay for our guaranteed leverage.

Thus, for the SBIC program, the choice is fairly simple. If we want to increase to the level where the demand is and where the small businesses can use the money, we need to impose the fees. We join with those who say that there has to be a revisiting, if you will, or a critique of the subsidy models and perhaps in the SBIC program we would find that they were too conservative as well because money has been released from that program as well.

But at this time, increasing the fees would produce three positive results: it would reduce the cost to the government of the program, making more money available for other purposes; it would increase the equity capital available to small businesses; and it would continue the growth and leverage necessary to attract private capital to the program.

Thank you, Mr. Chairman, and members of the committee. We value our working relationship with you and we look forward to working again with you this year.

[Mr. Mercer's statement may be found in appendix.]

Chairman MANZULLO. Thank you.

Ms. Finch.

STATEMENT OF ZOLA FINCH, VICE PRESIDENT FOR CONGRESSIONAL RELATIONS, THE NATIONAL ASSOCIATION OF DEVELOPMENT COMPANIES

Ms. FINCH. Good afternoon. My name is Zola Finch and I am the Vice President of Congressional Relations for the National Association of Development Companies or NADCO. I am also the Director of Finance Programs for Rural Missouri, Inc. and we are the statewide certified development company. We also administer four other economic development financing programs to small businesses and one of those is the SBA microloan program as well.

I am pleased to be invited by the committee to provide comments on the SBA fiscal year 2002 budget and ask that my written statement be entered into the hearing record.

Chairman MANZULLO. All of the written statements will be entered into the record without objection.

Ms. FINCH. Thank you.

We have four objectives in providing this testimony to the committee. First, NADCO would like to comment on the 504 authorization level and the proposed borrower fee contained in the FY 2002 budget for SBA. Secondly, our statement compares some of the 504 performance projections by SBA and OMB with the actual performance to date for the 504 program. Third, we will comment on some of the SBA performance plan objectives submitted to Congress with the fiscal year 2002 SBA budget. And, fourth, we will provide the committee with several 504 program proposals that could result in additional enhancements as we serve America's small businesses.

First, NADCO supports the current program reauthorization level passed by Congress last year, rather than the administration proposal of $3.75 billion. With 504 having a zero appropriation, there is no cost to the taxpayer for the current ceiling of $4.5 billion.

We believe this higher authorization level may well benefit small businesses if the current economic slowdown continues to restrict private sector lending.

We also appreciate the continued reduction in the program borrower fee. Going from .472 down to .410 for fiscal year 2002 will mean a total reduction of over 50 percent from fiscal year 1997 fee which was imposed when the program was taken onto a zero subsidy.

However, we continue to have major concerns about the calculation of this and the other program fees. Three of the primary assumptions used in calculating our fees is the default rate, the loan recovery rate and the debenture prepaying rate.

The default rate calculated by SBA and OMB went down from 11.1 percent to 8.41 percent for fiscal year 2002. We are very interested in how the administration computed this, since actual defaults have been fairly stable for a number of years and I would like to refer to the second chart in my written testimony, which was actually provided to NADCO from the Bank of New York, our trustee for the program. This is private industry information provided to us and has been provided to OMB and SBA over the years and has not been taken into consideration in the calculation of the subsidy model.

As revealed in this chart, the rate of debenture prepayments has declined over 50 percent in the last three years. Please note that this has occurred during both times of increasing interest rates and decreasing interest rates. We are troubled by the administration's forecast of prepayments moving up from about 40 percent to almost 50 percent of our loan portfolio.

The administration's forecast giving us the greatest concern is the SBA estimate of recovery rates on future loan defaults. This projection decreased from 31 percent to an unfathomable 26.93 percent. Conversely, the results of both the CDC liquidation pilot program and the SBA asset sales paint a much more favorable pictures.

With the liquidation pilot program focusing on loans from 47 CDCs, both SBA and CDC staff are averaging about a 60 percent recovery on defaulted loans. The average recovery rate for 778 504 loans from three asset sales was reported by SBA at 46 percent. Given our experience with the CDC liquidation pilot and SBA figures on the three asset sales, we can find no justification for another decline in this important program statistic.

Thirdly, the fiscal year 2002 performance plan is of great interest to the CDC industry. As lenders and taxpayers, we are all concerned about the prevention of loan program fraud and abuse. However, it is simply taking too long to authorize, approve and close 504 loans. It is clear that the agency must do something to improve the procedures it has developed for all lenders to work with to protect against loan fraud. These cumbersome procedures are grinding, however, the loan process to a crawl by requiring weeks or even months to process and handle verifications that could be done in days or hours.

Fourth, NADCO strives to meet the changing needs of America's small businesses. Therefore, the 504 program just remain dynamic and ready for change and renewal. We have recently completed a major strategic analysis of the program and we will be bringing our recommendations to this committee.

Mr. Chairman, you and the ranking member have already shown support of the 504 program. We have serious questions, though, and doubts about the current assumptions going into the administration's 504 cost model. We ask for your assistance in getting to the bottom of the extreme and inconsistent forecasts so that we might see lower borrower fees which our portfolio performance reflects.

Thank you for this opportunity to testify and I would be happy to answer any questions.

[Ms. Finch's statement may be found in appendix.]

Chairman MANZULLO. Thank you very much. I am sorry we misspelled your first name. It says Lola on there, but it is Zola.

Ms. FINCH. That happens frequently. It is Zona.

Chairman MANZULLO. Mr. Means.

STATEMENT OF DAVID MEANS, EXECUTIVE DIRECTOR, GREATER NEWARK BUSINESS DEVELOPMENT CONSORTIUM

Mr. MEANS. Thank you, Mr. Chairman, and members of the committee, for this opportunity to testify before you today. My name is David Means. I am Executive Director of the Greater Newark

Business Development Consortium (GNBDC) in Newark, New Jersey and a member of the Association of Enterprise Opportunity (AEO), the nation's only micro enterprise development trade organization. My testimony represents the views of AEO, as well as the Greater Newark Business Development Consortium.

I am a retired banker with 33 years experience. I retired as Senior Vice President responsible for Branch Administration, Operations and Legislative Relations.

My interest in community development began early in my banking career as project manager for the bank's Urban Development Housing Program. Today, I am the director of New Jersey's leading SBA/Microloan Program. Over the past seven years, GNBDC has borrowed from the SBA directly or indirectly $3,523,139. The GNBDC has approved and closed 207 loans for $3.2 million, with an average loan of $22,000. The default rate is a low 6 percent with 57 borrowers already fully repaid.

My organization also has a full technical assistance program, training and technical assistance program of 27 hours. We have a component small business mentoring program also.

The theme of our organization is make the loan, then make the loan work.

A.E.O., founded in 1991, is the national association of organizations committed to microenterprise development. The AEO provides over 400 organizational members with a forum, information and a voice to promote enterprise opportunity for people and communities with limited access to economic resources. A good number of AEO members are SBA intermediaries as well as Women's Business Centers. AEO has three policy priorities for this fiscal year. They are to fund the SBA microloan technical assistance and loan capital programs at $30 million each; to fund the Office of Women's Business Ownership's Women Business Center Program at $13.7 million, and to fund the PRIME program at $15 million for fiscal year 2002.

Microenterprises are small businesses with five or fewer employees that have difficulty accessing small amounts of credit from conventional sources. Many microentrepreneurs, particularly those served by microenterprise development organizations, are low income, women, minorities or disabled individuals who may face other challenges to business success as well. The Aspen Institute estimates that there are at least 2 million low income microentrepreneurs in the United States.

As I mentioned earlier, in order to meet the demand for training and technical assistance and credit among microentrepreneurs, AEO urges Congress to support and acknowledge the distinct and complementary programs within SBA and to assist microenterprise development organizations to serve more entrepreneurs effectively.

Convention sources of business credit, such as banks, are often beyond the reach of microentrepreneurs. These potential borrowers often seek very small amounts of capital, have poor credit histories and can offer banks little or no collateral. The SBA microloan program contributes to solving this problem by providing funding to over 160 community-based intermediaries to help microentrepreneurs gain access to credit. To date, these intermediaries have made more than 12,000 microloans totalling over $130 million.

Since microloan borrowers require training and technical assistance to start or expand their business, the SBA microloan program also provides funding to intermediaries who offer these services. In contrast to PRIME, however, this program supports the training and technical assistance needs of borrowers and provides only minimum amounts of funds for technical assistance to individuals who do not borrow.

The SBA's Office of Women's Business Ownership (OWBO) is the only federal office that specifically targets women business owners. Its Women's Business Centers provide training and technical assistance to women starting or expanding businesses. There are a total of 92 Women's Business Centers. Fifteen new centers were opened this past year.

Finally, in order to succeed in our complex economy, microentrepreneurs need training and technical assistance in areas such as financial management, bookkeeping and marketing. Fifty percent of the PRIME Act funds are to be used to support training and technical assistance for low income entrepreneurs. PRIME funds also enable non-profit microenterprise organizations to build their management, outreach and program design capacity so that they can more effectively serve low income clients. PRIME funds can support the full range of non-profit of organizations that assist microentrepreneurs, not only those organizations providing microloans.

I will reserve the comments of the last part of this presentation of the testimony, they are comments to me from some of our borrowers. I think it is widespread throughout the organizations.

[Mr. Means' statement may be found in appendix.]

Chairman MANZULLO. We are going to go and vote and come right back.

[Recess.]

Chairman MANZULLO. I have just a couple of questions and it would be of Ms. Wolverton.

Ms. WOLVERTON. Yes?

Chairman MANZULLO. There was a bill that has been introduced by Congressman John Sweeney of New York called the National Small Business Regulatory Assistance Act, H.R. 203, that would allow Small Business Development Centers to offer advice and refer clients to resolve various environmental and workplace related problems.

What would your opinion of that be?

Ms. WOLVERTON. Well, Mr. Chairman, I have not seen the bill, but I am familiar with the concept and also that the Small Business Development Centers have asked, I think, since 1996 to assist businesses with these regulatory compliance issues and they are big issues for small business. We have been doing it on a limited basis because we have not had the financial resources to assist that. Some states have been able to find grants and have quite extensive programs, but this to me from first blush sounds like an opportunity to enhance that and to be able to offer that to the businesses when they are in the stage of learning how to set up their business and not to build a building that is not in compliance, not to set up procedures that are going to cause damage and fines later on down the road, so we think this is an excellent opportunity.

Chairman MANZULLO. What do you do now when somebody has an environmental question? Do you refer them to the local EPA or what do you do?

Ms. WOLVERTON. Well, in Wyoming, I can speak that we do have a government office, it is the Department of Environmental Quality in Wyoming and they have what they call an Office of Business Outreach and so we do work in partnership with them, we have done some programs with them. And also one of the issues is in referring businesses to them, though, is there is a little fear that this is a regulatory agency and that if the business comes and is open about what they are doing that they will be shut down. And so they do have that office, there is some resistance to it, but we feel that with a partnership arrangement, and we have been working to forge those partnerships in different states, that this is a delivery system that could work very well.

Chairman MANZULLO. Well, I guess my question would be what level of training would the SBDC people have to have? I mean, as it stands now, any time somebody has a question, you have the authority to refer those people to the appropriate agencies. Is that correct?

Ms. WOLVERTON. Yes. Yes. Absolutely.

Chairman MANZULLO. And my question is if somebody comes to the SBDC, I mean, an environmental workplace-related problem, these are highly technical.

Ms. WOLVERTON. Exactly.

Chairman MANZULLO. Would it not be kind of dangerous going off into an area where you——

Ms. WOLVERTON. Absolutely. And we would never intend—just as we do not give legal advice, we know to call in the experts that have the technical assistance in that area. Absolutely.

Chairman MANZULLO. Do you have brochures from these other agencies that you give to people that may have a question on workplace related problems such as wage and hour issues? Do you already furnish that to them?

Ms. WOLVERTON. Yes, we do.

Chairman MANZULLO. Okay. Does anybody else here have any input on that?

(No response.)

Chairman MANZULLO. Okay.

You came back just in time to ask a question.

Ms. VELÁZQUEZ. Thank you. Thank you, Mr. Chairman.

Mr. Wilkinson, why do you think the SBA subsidy estimate for the 7(a) program has been wrong year after year and then what can we do to try to fix it?

Mr. WILKINSON. That is the same question we have been asking for quite some time. From our perspective, it looks like OMB still requires a default estimate that is well beyond what this program is being managed to today, yet they continue to want to hang their hats on the old SBA way back into the 1980s that had high default rates and that is just not the program we have today. So the OMB could quickly fix some of their problems by using a more realistic default estimate in the model.

Ms. VELÁZQUEZ. So, Mr. Chairman, are we going to do a hearing where we could bring here OMB and deal with this issue?

Chairman MANZULLO. I think they are here now in the back.

Ms. VELÁZQUEZ. But they are not testifying.

Chairman MANZULLO. No, but we can——

Mr. WILKINSON. They were here for a while. I do not think they are here now.

Chairman MANZULLO. Oh, they left?

Mr. WILKINSON. Yes, sir.

Chairman MANZULLO. Yes, we can bring them in. We will be glad to let you ask them some questions.

Ms. VELÁZQUEZ. Sure.

Chairman MANZULLO. I am sure you might have a few.

Ms. VELÁZQUEZ. I guess so.

Mr. MERCER. Can I reserve a seat for that hearing? That will be standing room only.

Ms. VELÁZQUEZ. Mr. Wilkinson, what kind of response did you get from SBA when NAGGL told then you wanted to do an outreach program to increase credit availability among under served populations?

Mr. WILKINSON. As you know, the agency and NAGGL entered into a cosponsorship agreement after those discussions whereby we provided training to intermediaries that work with minority and women-owned businesses and we put on training classes throughout the country and looking at the loan dollars and women and minority loans from 1998 to 2000, you will see that there was a good increase across the board in all categories.

Ms. VELÁZQUEZ. Would you please comment on Mr. Whitmore's analysis of 7(a) lending by ethnicity and gender?

Mr. WILKINSON. Well, again, I agree that picking on 1995 was the wrong year to choose, that was an anomaly and not a good choice of years to pick because there has been a good trend, as you can see, from the charts.

Clearly, we can always do a better job, but when you go back to 1996, we had a change in fees that dramatically drove up the cost of the program to both borrowers and lenders and there was a decrease in participation. It is very clear that any dollars that could have been used for incentives with those small loans have been scraped off the table by OMB and sent to Treasury. And I again come right back to OMB, they have taken all the money away which we could use to try to provide incentives on small loans.

I disagree with Mr. Whitmore that you do not stipulate the volume of loans $150,000 or less by doing nothing, which is in the administration's proposal.

Ms. VELÁZQUEZ. Thank you.

Mr. Means, the administration's budget does not request any funding for PRIME. In addition, the administration has declared their intent to eliminate the program all together, arguing that it duplicates programs like the microloan program and CDFI.

As a participant in the microloan program, do you believe that the PRIME program offers something different from the 7(m) program?

Mr. MEANS. Yes, it does, because the PRIME program is a fund for giving counselling and technical assistance pre-application, preloan application, which is extremely important when you are dealing with microloan enterprise individuals going into business. You need a thorough understanding of what going into business is all about and this comes before the application. Yes, it is different.

Ms. VELÁZQUEZ. Thank you.

Ms. Wolverton, what will be the impact of fees on your match?

Ms. WOLVERTON. That is an excellent question because the match providers from our various states provide the match with the understanding that it is for an outreach program that is offered free and the addition of fees would be a huge disincentive for them to participate in this program.

Ms. VELÁZQUEZ. So what do you think the effect on the host institutions will be?

Ms. WOLVERTON. The host institutions will look at the burden of calculating the fees, they will look at the publicity detraction from people who were being able to receive these services not being able to receive them any more. The host institutions have used this as an outreach. For example, the University of Wyoming has an outreach program. It was earlier mentioned do we charge farmers to contact the Department of Ag? We have outreach with our ag extension agents and they do not charge. And so it would be an anomaly within what the host institutions do and many of them may decide to pull out of the program.

Ms. VELÁZQUEZ. Ms. Wolverton, there is a very hot topic in terms of the privacy issue.

Ms. WOLVERTON. Yes.

Ms. VELÁZQUEZ. Whether it is financial, personal or medical records. More and more people are concerned that critical private information may be disclosed. How important is the privacy issue in terms of business information to your clients?

Ms. WOLVERTON. Well, I guess the best answer I can say to that is how often do we walk up to someone and ask them how much money they make? It is an extremely private issue and we are discussing these things, we have these things in paper form and it is just absolutely unacceptable for our clients to think that this could be made public or made known.

Ms. VELÁZQUEZ. It concerns me because recently I was made aware that the Virginia SBDC was required to turn over their client list to the local SBA office.

Ms. WOLVERTON. This is also very troubling because not only are the clients very protective of the information that is in the file, but the fact that they walk through our doors is also something they like to keep private. For example, some of them may be employed in another place and they are getting ready to start a business and they really do not want that known; some of them may be in trouble financially, they do not want that known, it could impact maybe a potential sale of the business or their customers having confidence in them. So they do not even want people to know who they are coming into our offices.

Ms. VELÁZQUEZ. Do you think that this could——

Chairman MANZULLO. Could you yield a second?

Ms. VELÁZQUEZ. Yes.

Chairman MANZULLO. On that issue with Virginia, I would be willing to sign a letter with you to the state organization that is in charge of the VASBDCs and find out by what authority they are getting these lists and for what purpose they are using them.

Maybe we should send a letter to all 50 states to see if they are doing that.

Ms. VELÁZQUEZ. Yes. I would like to do that, but I would like to ask her if you consider that this committee should consider some statutory changes to ensure the confidentiality because, look, this is one office, but what about if it happens in some other regional offices?

Ms. WOLVERTON. We would welcome that. Our clients do sign a form that says their records will be kept confidential and yet they are still nervous, so if they knew there was some statutory relief they would be—I think that would go a long way to ensure their confidence. Yes. Thank you very much.

Ms. VELÁZQUEZ. Thank you.

Thank you, Mr. Chairman.

Chairman MANZULLO. I have no further questions.

Mr. Whitmore, did you want to respond to that last question on privacy that we talked about?

Mr. WHITMORE. You want me to respond.

Chairman MANZULLO. I mean, if you wanted to.

Mr. WHITMORE. Well, I would say that we don't have an electronic database nationwide.

Chairman MANZULLO. If you could do that, we would appreciate it.

Mr. WHITMORE. It would be possible to have a nationwide database and track clients but not by names.

Chairman MANZULLO. Okay. Just by function.

I want to thank you all for coming. After the first panel, those of you who are not used to testifying figured why I am here, coming this long distance to do this. We really want to thank you for coming and testifying before us today.

Mr. Whitmore, thank you for participating in the first panel and sitting through the testimony of the second panel. I really commend the SBA for always having somebody here; oftentimes, the administrator is here or acting administrator to gather firsthand what is going on.

Again, thank you very much.

This committee is adjourned.

[Whereupon, at 12:46 p.m., the committee was adjourned.]

DONALD A. MANZULLO, ILLINOIS
CHAIRMAN

NYDIA M. VELÁZQUEZ, NEW YORK

Congress of the United States
House of Representatives
107th Congress
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-0515

May 16, 2001

OPENING STATEMENT

CHAIRMAN DONALD A. MANZULLO
COMMITTEE ON SMALL BUSINESS

U.S. Small Business Administration
FY 2002 Budget Request
and
Performance Plan

Good morning and welcome to this hearing of the Committee on Small Business. A special welcome to those who have come some distance to participate and to attend this hearing.

I applaud those parts of the President's budget which will fund America's important priorities, that reduce the federal debt, and that provide for tax relief for the American people.

However, I disagree with a number of items contained in the President's budget request for the Small Business Administration.

Specifically, I disagree with the increases in the fees for the 7(a) Loan Program when the budget submission shows a substantial surplus. The subsidy rate has been unfairly set so the borrowers are paying more than a user fee. They are paying a tax.

I disagree with the increase in the interest rate for loans to businesses without credit under the disaster loan program. I don't know how anyone could suggest increasing fees for persons who have just lost their businesses as the result of a flood or earthquake. This proposal is a double disaster to them.

I disagree with the proposal to charge fees for persons seeking business advice from their local Small Business Development Centers. Is the Administration going to charge farmers for assistance from the Department of Agriculture or the taxpayer who calls the IRS 800 number?

I also disagree with the failure to request funding for three technical assistance programs. There may be some redundancy, but a case not been made as to how SBA intends to make up for the services small businesses would lose if the programs were terminated.

As you can see, I am concerned about the specifics of the President's budget as it impacts the SBA. You may be assured that I will remain concerned until the issues are resolved.

Thank you again for attending this hearing. And I look forward to the testimony of our witnesses. I yield for an opening statement from my good friend, Ms. Velazquez, the ranking minority Member from New York.

DONALD A. MANZULLO, ILLINOIS
CHAIRMAN

NYDIA M. VELÁZQUEZ, NEW YORK

Congress of the United States
House of Representatives
107th Congress
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-0515

Congresswoman Nydia M. Velázquez
Ranking Democratic Member
Statement on the Bush Administration Proposed Budget
U.S. House Small Business Committee
May 17th, 2001

Thank you, Mr. Chairman.

Earlier this year when we met to consider the Small Business Administration's Budget Request, I said at the time that this budget was - - - without a doubt - - - the worst I had seen in my three years as Ranking Member - - - AND my nine years of service on this Committee. And, Mr. Chairman, I have seen nothing in this budget that changes that opinion - - - nor am I likely too. One of the critical roles the SBA plays in helping small businesses is providing for those who cannot - - - for whatever reason - - - receive access to the capital necessary to either start or grow their business. That is why this proposal to replace the current SBA loan appropriations with a fee system is so dangerous - - - and, indeed reckless. For example, the average small business borrower in the 7(a) loan program will, under this proposed structure, pay thousands of dollars in up-front AND on-going costs. And with these costs attached to both borrowers and lenders - - - we will create a situation where fewer and fewer banks offer these loans and therefore close off a vital source of capital to small business owners.

Is that what we should be doing in an economy that has more questions than answers? Shouldn't we be making it easier to access these programs so that small businesses - - - the real economic foundation of this country - - - - can help lead us back to prosperity as they have done in the past. This budget is a formula for disaster. By cutting off access to capital - - - you are cutting off access to opportunity. It is just that simple. To add insult to serious injury, the President's budget proposes to impose fees on the critical disaster loan program. As a result, many entrepreneurs will never be able to rebuild their businesses without being saddled with a literal mountain of debt - - - so the business and the jobs it provides are gone forever. And I wonder - - - is this what President Bush meant when he campaigned as a "compassionate conservative?"

What is even more alarming is that under this budget - - - small businesses will be forced to pay for the counseling and technical assistance provided through the Small Business Development Center program. And those of you who have owned a small business know - - - that businesses receiving critical technical assistance - - - are more likely to succeed than those that do not. These new "fees" will force many businesses - - - many of whom can hardly afford added expenses - - - to go without technical assistance. The result - - - the business community will be subjected to increased business failure and bankruptcies.

Somehow, I don't think that is something we need in this economy. What concerns me is that the vast majority of SBDC's are located in minority communities that are trying to build a new life in areas that economic prosperity has somehow forgotten. And now we tell them "just wait a little longer because we have to get the economy back on track." Well, I am here to tell you that these communities cannot wait any longer. These entrepreneurs as well as others around the country need help now - - - not when this tax cut finally "trickles" down to them. That is why it makes absolutely no sense to me that this budget chooses to eliminate programs like PRIME, BusinessLINC and the New Market Venture Capital Program.

Not coincidentally, these were programs aimed at building new economic anchors who have yet to benefit from the boom of the last decade. Let me say for the record, that this budget has failed in both Houses of Congress and in a very bipartisan fashion. My colleagues, everyone on the Committee knows the important role that small businesses play in our nation's economy. That is why this budget represents such a disconnect between the White House and the reality of this economy.

In closing, let me say simply that this is a bad budget and it will be bad for small business. This budget fails us in so many ways - - - particularly given the fact that this proposal does not take into account that the economy is no longer operating at peak efficiency. We must have a budget that recognizes these changes and puts us on back on the road toward economic growth. Without a reasonable budget plan, we are placing America's economic foundation - - - and the key to future prosperity - - - at risk of failure. It is something that none of us can afford.

And as my father always told me, " If you fail to plan, plan to fail." Small business owners and future entrepreneurs are counting on us to do the right thing by them - - - let's not let them down by passing an irresponsible budget.

Thank you, Mr. Chairman.

STATEMENT OF

JOHN WHITMORE
ACTING ADMINISTRATOR

U.S. SMALL BUSINESS ADMINISTRATION

SBA'S FISCAL YEAR 2002 BUDGET REQUEST

BEFORE THE

COMMITTEE ON SMALL BUSINESS

UNITED STATES HOUSE OF REPRESENTATIVES

MAY 16, 2001

Mr. Chairman, Ranking Member Velazquez, and members of the committee, thank you for inviting me here today. I am pleased to present the U.S. Small Business Administration's (SBA) budget request for Fiscal Year 2002. This request of $539 million signals a renewed focus on SBA's core programs and a commitment to do them well. It will provide record levels of credit, capital, procurement, and entrepreneurial development assistance to America's 25 million small businesses at one of the lowest costs to the taxpayers ever. This is a fiscally sound budget request that will provide more than $17.5 billion in loans and guarantees, and counseling and training assistance to over 1 million firms and entrepreneurs, to help them start, sustain and grow their businesses.

As I said, this budget request will allow us to focus on our core programs and delivering them to those who need them most. The proliferation of new programs at the SBA has come at a cost of diluted focus and lack of attention to our bread and butter programs. We are concerned with the recent performance of key programs, such as our 7(a) loan, 8(a) business development assistance, and HUBZone programs. We are concerned that neither our programs nor our delivery structure are ready to serve small business needs in 2002 and beyond. We will present the Administrator, upon his confirmation, with an array of decision options to address these and other concerns.

FINANCIAL ASSISTANCE PROGRAMS

President Bush's budget will provide SBA's Financial Assistance Programs with a record level of financial support to our nation's small businesses - $17.5 billion. SBA's 7(a) Loan Guaranty Program, SBA's primary loan program, will support $10.7 billion in lending while saving the taxpayers $114.5 million. The savings will be accomplished by increasing the tax-deductible fees to those who benefit from the larger loans in the 7(a) program and to those Small Business Investment Companies using participating securities. However, loans of $150,000 and less will have no change in their fees. In FY2000, of the 43,748 total number of 7(a) loans, approximately 60 percent were under $150,000. For specific groups of borrowers, loans under $150,000 made up:

- 69 percent of the 2,000 loans to African Americans,
- 58 percent of the 5,359 loans to Asians,
- 65 percent of the 3,221 loans to Hispanics
- 81 percent of the 525 loans to Native Americans,
- 69 percent of the 4,809 loans to veterans, and
- 74 percent of the 9,206 loans to women.

From FY1995 through FY2000, the number of SBA 7(a) loans dropped from 55,591 to 43,748, while the dollar volume of loans increased from $8.26 billion to $10.5 billion. The number of loans to Asian-Americans went up dramatically, but for Native Americans, other minorities, women and veterans, loan numbers have remained level or gone down slightly—even though businesses owned by Hispanics and women were the fasting growing segments of the business community.

In an effort to encourage more of these smaller loans, the President's proposal makes no change in fees for loans under $150,000. The proposal aims to encourage the smaller loans that many banks are reluctant to make, which are the ones that help the neediest of small businesses.

Finally, eliminating the need for appropriations will ensure that the 7(a) Program will not run out of money if there is a significant increase in demand, an approach that has worked well for other SBA programs.

The 504 Certified Development Company Program provides financing for major fixed assets. The program will provide $3.75 billion in lending in FY 2002, the same as FY 2001, with a slight decrease in the fee paid by the users of the program. This program has not had a subsidy from taxpayers since FY 1996. The 7(a) proposal is based on the 504 model.

Through the Microloan Direct Program, SBA provides small loans up to $35,000 to small businesses through a network of locally based not for profit intermediary lenders. The FY 2002 budget will provide $20 million for new loans to intermediary lenders. The average loan to microborrowers in this program is $10,500 and over the last five years the average number of microloans made each year has been around 1,500. Small businesses in economically distressed urban and rural areas have benefited from this program. The Microloan technical assistance aspect of the program will also receive $20 million in FY 2002. These funds will be used to support technical assistance to microborrowers, increasing their chance of success and enhancing their ability to repay their loans. Training and other technical assistance will also be funded to help additional microbusinesses obtain financing from sources outside SBA.

The program level for the Small Business Investment Company (SBIC) Program, a venture capital investment program, will increase to $3.1 billion in FY 2002, an increase of $600 million over FY 2001. With a small increase in fees for participating securities, the SBIC Program, including the debentures program, will be fully self-supporting. I note that the National Association of Small Business Investment Companies accepts this approach because it allows for a larger program volume.

The Surety Bond Guarantee Program guarantees bid, performance, and payment bonds for small business contractors working on construction, service and supply contracts for public and private sector projects. The program will be level funded at $1.7 billion and does not require taxpayer funds.

COUNSELING & TECHNICAL ASSISTANCE PROGRAMS

The budget provides $5 million as SBA's share of the President's New Freedom Initiatives. The funds will provide technical assistance to help small businesses comply with the Americans with Disabilities Act (ADA) and hire more people with disabilities. This funding will also help SBA increase awareness and promote use of the Disabled Access Credit, which provides a 50 percent tax credit on up to $5,000 of eligible expenses annually to help small businesses make their facilities ADA compliant.

The budget includes funding for the Paul D. Coverdell Drug-Free Workplace Program that awards grants to organizations helping small businesses establish drug-free workplace programs. This is part of the President's initiative to combat drug abuse. To date, SBA has not been able to meet the demand for assistance from intermediary partners. For example, in 1999 SBA received 160 grant applications from intermediaries, but issued only 16 grants. To help meet this need, the President's budget includes $5 million and proposes to spend $25 million over the next five years.

Business Information Centers (BICs) provide both counseling and information for start-up and early operating businesses. There are 70 locations nationwide in both distressed and non-distressed areas. The program will be level funded at $500,000.

One Stop Capital Shops (OSCSs) provide financial and business assistance to small businesses. Located in 22 socially and economically disadvantaged areas nationwide, OSCSs will be level funded at $3.1 million.

Small Business Development Centers (SBDCs) provide management and technical-assistance. This 21-year old program has slowly evolved as a counseling program for more mature businesses, not start-up businesses, although SBDCs do counsel some start-ups.

SBDCs will receive $76 million in FY 2002, plus $12 million through the collection of nominal fees-for-counseling, as is currently done for training. After the initial *first free hour*, the estimated cost will be $10.75/hour. The average use of counseling is 5.3 hours, which means the average client will pay $46.23 for counseling. The fee proposal will allow the program to continue to grow while reducing the expense to the taxpayers. Currently the average SBDC counseling case costs Federal and state taxpayers approximately $700.

Charging fees is not precedent setting. SBDCs have always charged fees for training and other services, such as publications and conferences. Some SBDCs already impose a variation on a counseling fee by requiring new start up businesses to take their training course, at a cost of $35-$45, before receiving any counseling. During 1998 (the latest year that figures are available), SBDCs generated over $7 million of program income over and above their Federal and matching funds.

Beneficiaries of most SBA programs pay fees, directly or indirectly, including fees for loan programs, investment capital, pre-qualification counseling. Even some of our small Women's Business Centers charge fees in excess of $50 per hour for counseling.

In FY 2000, the SBDCs trained 326,000 clients and counseled 262,000 clients. From FY1995 to FY2001, SBDCs funding increased $14 million while funding for SCORE only increased $500,000 and funding for 7(j), a technical assistance program for all low income areas as well as 8(a), was reduced by $4.5 million.

For the Service Corps of Retired Executives (SCORE), we are proposing to increase to $4 million the amount to help pay the expenses of the 11,400 SCORE volunteers. These volunteers counseled and trained over 377,000 clients in FY2000. SCORE is making more and more use of electronic means to be able to use its expert counselors anywhere in the country.

A recent *Washington Post* article recounted how SCORE counselors Gene Rosen and Herbert Robinson helped Sarah Hill start an antique business in Alexandria, Virginia by providing invaluable assistance on many aspects of their business, from negotiating the lease to pricing merchandise. The time and advice of these volunteers was free. The government paid 34 cents a mile for their expenses. Sarah is projecting annual sales of over $100,000 in each of the next several years.

The SBIR (Small Business Innovation Research) Program awards grants or contracts to small businesses for their innovative ideas to meet the specific research and R&D needs of the federal government. SBA's budget will provide $5.0 million in FY 2002 to fund two programs to help small businesses compete for SBIR awards. The FAST (Federal and State Technology Partnership) will receive $3.5 million under this proposal. The SBIR Technical Assistance Outreach Program will receive $1.5 million.

A nationwide network of U.S. Export Assistance Centers (USEACs) combine in single locations the trade-promotion and export-finance assistance of the SBA with the programs of the Department of Commerce and the Export-Import Bank. USEACs will be level funded at $3.1 million.

The Veteran's Business Outreach Program will receive $750,000 in FY 2002. The program ensures that small businesses owned and controlled by eligible veterans have access to entrepreneurial training, business development assistance, counseling and management assistance. The program was not funded in FY 2001. The Veterans Business Development Corporation, which was funded at $4,000,000 in FY 2001, will no longer be funded through SBA's budget, but will have its own separate appropriation.

Women's Business Centers (WBC) provide women entrepreneurs with business training and counseling, technical assistance, mentoring, and access to SBA's programs and services. The centers also have programs to assist economically and socially disadvantaged women, especially those on welfare. Each center tailors its services to the needs of the local community. SBA awarded 15 new grants, funded 62 centers with regular grants, and provided sustainability grants to seven centers with its FY 2001 appropriation of $12 million. In FY 2002, the budget request is for $12 million.

The Women's Council supports programs and research on behalf of women's business enterprise. In the President's Budget, the Council will receive $750,000 in FY 2002.

In FY 2000, women business owners received only 2.8 percent of Federal procurement dollars. The Office of Federal Contract Assistance for Women Business Owners (CAWBO) was established within SBA's Office of Government Contracting to increase the number and size of federal contracts to women business owners. Additionally, the Office of Government Contracting is charged with providing studies on how contract bundling affects all small businesses. We request $500,000 to implement a recently-enacted procurement initiative, including conducting a legislatively mandated study on women's procurement, creating a contract bundling database, and conducting analysis of procurement trends and practices.

The 8(a) Business Development (BD) Program assists the development of small companies owned and operated by socially and economically disadvantaged individuals. Eligible companies may be awarded set-aside federal contracts and other business development assistance. The number of contracts in this program has gone down. The new Administration is looking at ways to more efficiently and effectively run this program. In the interim, funding for FY2002 is requested at the same level as FY2001.

The HUBZone (Historically Underutilized Business Zone) Program encourages economic development in distressed areas through the establishment of Federal contract award preferences for qualified small businesses located in such areas. This program has gotten off to a very slow start. Under the President's budget, the program will receive $2 million in FY 2002, the same as FY 2001 again with an emphasis by the new Administration on more efficient and effective ways to fulfill the intent of the program.

PRO-Net (Procurement Marketing & Access Network) is a government-wide online database used as a link to procurement opportunities and as a marketing tool for small companies. We request level funding at $500,000.

The 7(j) Technical Assistance Program provides management and technical assistance to small and emerging businesses owned and controlled by socially and economically disadvantaged individuals and also individuals in areas of low income and high unemployment. Under the President's budget, the program will receive $3.6 million in FY 2002.

DISASTER ASSISTANCE LOAN PROGRAM

The Bush Administration is fully committed to meeting the needs of disaster victims and has proposed a base loan volume of $300 million for SBA's Disaster Assistance Loan Program. Additional needs for the Disaster Program will be funded through the proposed National Emergency Reserve.

However, there will be no interest rate change for disaster home loans. Under the President's proposal, businesses without access to credit elsewhere will receive disaster assistance loans at the U.S.Treasury Rate, with a ceiling of 8 percent. Based on current rates, the business loan interest rate would be increased from the current 4 percent ceiling to 5.4 percent. On an average loan of $56,300 over 15 years, the monthly payments would rise from $429 to $473. Over the life of the loan, the business would incur an additional cost of $7,344. Also, SBA will have the flexibility of keeping the payment at $429 by extending the maturity of the loan.

SBA OPERATING COSTS

Although the budget request proposes a small increase in SBA's operating costs, we are looking at streamlining SBA's operations and doing away with redundant programs. SBA will contract out, as appropriate and consistent with the Federal Activities Inventory Reform (FAIR) Act, and will continue its asset sales program.

A major challenge facing SBA is improving its level of customer service to meet the growing and changing needs of small business. Over the last 10 years, SBA has dramatically changed the way it delivers services to small business, using private-sector partners to make and service its loans and to provide training and counseling. Yet the structure has not changed. For example, by taking advantage of electronic commerce, the oversight function carried out today by SBA's Procurement Center Representatives could be streamlined and centralized.

SBA has been downsized over the last eight years, but its structure has not. SBA still needs to reduce its staff while maintaining critical positions.

SBA met with GAO on April 27, 2001 to discuss the findings in its study of SBA's structure. We will take an aggressive look at additional privatization and streamline what we do to reduce duplication and increase efficiencies. We will develop succession plans and reprioritize the use of resources. We will be preparing options for the confirmed Administrator to ensure that both SBA's programs and structure can serve America's small businesses efficiently and effectively.

LOAN MONITORING SYSTEM

SBA's loan monitoring system (LMS), a four-year project authorized in December of 1997 with $8 million appropriated each year since FY 1998, is undergoing a substantitive review. In early February 2001, after I became Acting Administrator, I began looking into the status of the project. I have reported my findings to both your Committee and the Appropriators.

In brief, I have concluded that the LMS had become commingled with an internally-sought Systems Modernization Initiative (SMI). I have since ordered that the program be refocused on the activities for which the Congress authorized and appropriated the funds–an information technology-based system for risk management, lender oversight, and loan monitoring. SBA intends to carefully examine the operational risk management/loan monitoring systems of a number of established financial institutions. Rather than develop a proprietary system – with all its attendant costs and risks – we intend to determine if a system already exists that could be modified to meet the agency's needs.

To this end, we have put Janet Tasker in charge of overseeing all of our lender and portfolio oversight. She is a Certified Public Accountant (CPA) and served as the Director of the Office of Government Sponsored Enterprises Oversight, responsible for providing oversight to FANNIE MAE and FREDDIE MAC. She is taking the lead for the LMS project and has developed the overall requirements for our LMS system. These concepts have been presented to your staff and the GAO. Furthermore, last week we signed a contract with KPMG Consulting to provide SBA with the expertise to assess the various options available in both the private sector and other government agencies. Once our options are determined, a test will be run comparing the best of the systems examined. The results of that test will be presented to the new Administrator for his decision. In FY2002, we have requested an appropriation of $8 million to bring the original program's scope to completion.

At this point, I emphasize that the agency must have a new financial system in place by the end of this fiscal year—September 30, 2001—when the current Federal Financial System run by Treasury is scheduled to be phased out. SBA is proceeding with an Oracle-based integrated standard general ledger that will integrate program and accounting data, resulting in more timely and accurate financial reports and program analysis. This is one of the elements of SMI I felt we must pursue. In FY2002, we have requested an appropriation of $8 million to complete the scope of the original program. Other elements will wait for decisions by the Administrator after his confirmation.

PROGRAMS THAT WILL NOT BE FUNDED IN FY 2002

The Administration supports the objectives of the New Markets Venture Capital (NMVC) Program but believes those objectives can be achieved more efficiently and at a lower cost through other existing means. Several vehicles and incentives to direct investment into economically distressed communities already exist. Communities targeted by NMVC have access to a wide range of private for-profit and economic development programs, including the federally supported community development financial institutions administered through the Department of Treasury. In addition, SBA's SBIC program, which has 412 licensed venture capital companies with total capital resources amounting to $17.7 billion, is implementing incentives to encourage investment in economically distressed areas.

The NMVC Program is also expensive relative to the impact it is expected to have. The total cost of the program in FY 2001 is $52 million, not including the administrative cost of running the program. Since the program is expected to generate $150-$200 million of investment activity, it will yield only $3.00-$4.00 of investment for every taxpayer dollar spent. In comparison, under the Small Business Investment Company (SBIC) Program, there is no cost associated with the debenture portion of the program. The participating securities portion of the SBIC program required a $26.2 million credit subsidy in Fiscal Year 2001. Since this subsidy generates $3 billion of investment activity, each taxpayer dollar spent provides $114 of investment activity in the participating securities program.

The NMVC legislation also included a $15 billion tax credit for new investment in the same communities targeted by the NMVC Program. The Administration believes that targeted tax policy and other private sector incentives are the right formula to spur economic development with less emphasis on government outlays. The NMVC Program has been funded in FY 2001. However, until the program can show some results in the way of established return on equity, any additional funding would be premature.

The Program for Investment in Microentrepreneurs (PRIME) Program, like the NMVC Program, is duplicative of existing SBA programs and other programs within the Federal government and the private sector, i.e., community development organizations and local financial institutions (see attached chart). SBA has a wide array of funded grant programs that provide technical assistance to small businesses. SBA's Microloan Program, for example, provides grants enabling intermediaries to provide marketing, management, and technical assistance to individual microborrowers. Additionally, the Microloan Program provides funding to non-lending technical assistance providers to help low-income individuals start or improve their own business. Microloan intermediaries and non-lending technical assistance providers are the same groups targeted by PRIME grants. There are also other private-sector entities, such as trade organizations, whose members are engaged in the microenterprise industry and provide similar services. Other SBA programs available for these customers include SCORE, SBDCs, OSCS and WBCs.

The Business Learning, Innovation, Networking and Collaboration (BusinessLINC) program was designed to create and foster mentor-protégé relationships that would promote the growth of small businesses by matching them with larger concerns. The program is similar to other SBA technical assistance programs already in place. One of SBA's most successful technical assistance programs, SCORE, manages a nationwide network of 11,400 volunteers who provide free expert advice based on their many years of experience on virtually every aspect of business. SCORE's free counseling service provides a mentor framework to assist small businesses similar to that envisioned for BusinessLINC. The SBDC consulting service is another means of providing technical assistance and services to more mature companies seeking to expand their relationships or customer base to include larger concerns. SBA also provides the 8(a) mentoring program and a women's mentoring program. Other agencies such as the Department of Defense and NASA support mentor – protégé programs.

BusinessLINC is duplicative of SBA's 7(j) management and technical assistance program, which authorizes contract grants and cooperative agreements to organizations that provide direct assistance to small and emerging businesses owned by socially and economically disadvantaged individuals. SBA is authorized to target 7(j) services to businesses and individuals located in areas of high unemployment and low income. Many of these providers were successful in fostering business-to-business relationships between larger and smaller firms. Service providers report direct assistance to nearly 3,000 eligible businesses. Many BusinessLINC activities can be accomplished using the existing 7(j) authorization.

BusinessLINC was designed to provide small businesses with an online information source and database of companies interested in mentor-protégé programs. These goals may be achieved through existing BICs, WBCs, TBICs, OSCSs and PRO-Net. Private sector alternatives that would provide incentives for larger businesses to enter into mentoring programs should also be examined.

SBA's FY 2002 PERFORMANCE PLAN

SBA's FY 2002 combined budget request and performance plan is designed to increase accountability by describing goals and requested resources in a single, integrated document. The Bush Administration is currently reviewing what was done in the past and what should be done in the future to meet the needs of the small business community. The results of that review will be reflected in future performance plans, including specific goals and performance indicators.

As I mentioned at the beginning of my testimony, SBA's FY 2002 request is a good budget for small businesses. Thank you for the opportunity to appear here today. I will be happy to answer your questions.

IN BUSINESS

From Past Experience

Antiques Shop Owner Benefits From Wisdom of Veteran Entrepreneurs

By MARGARET WEBB PRESSLER
Washington Post Staff Writer

In a world where you can buy a hammer 24 hours a day at Home Depot and photocopy your résumé at Kinko's at 3 in the morning, Curzon Hill Antiques in Old Town Alexandria is an anomaly.

Open just five hours a day, Wednesday to Sunday, it seems like a quaint little shop from the same era as the historic town house it occupies.

But Curzon Hill is, in fact, a thoroughly modern business, if constrained somewhat by the limits of its sole proprietor. The store is owned and run by Sarah Hill, 29, who when not operating the store for 25 hours a week is frantically delivering antiques, scoping out new purchases, selling vintage knickknacks on eBay, washing antique linens for her linen service and otherwise making it as much of a 24-7 job as any other hypercharged entrepreneur.

"If you want to have this gorgeous tablecloth to buy, I've got to have time to wash it," she says.

And lucky for Hill, she went into business in an era when there were plenty of resources available to support and guide her fledgling enterprise. In particular, Hill is one of thousands of entrepreneurs nationwide who has received support, guidance and basic business advice over the years from the Service Corps of Retired Executives, a nonprofit program run by the Small Business Administration.

The program, known as SCORE, provides aspiring business owners like Hill with free, one-on-one counseling sessions with experienced entrepreneurs, lawyers and accountants on just about any aspect of launching and running a start-up.

That guidance proved invaluable to Hill, helping her with big issues, such as what kind of shop to open, to details as small as pricing merchandise.

Eugene Rosen, 80, one of Hill's two main counselors from SCORE, says Hill is about as perfect an example as there is of what SCORE volunteers hope to achieve when they donate their time and advice.

"She is one person I can always brag about," he says.

When Hill graduated from Mount Holyoke in 1993, she began working in the technical department of a big company, but computer work left her cold. The good pay and international travel couldn't compare with the personal charge she had always gotten from history and its artifacts.

She had grown up going to yard sales, church sales and estate sales with her mother, poring over piles of junk in search of a gem. She was especially fond of old porcelain, while her mother collected antique linens and textiles.

Eventually, Hill's pastime overflowed the limits of hobbying and became a business, almost by default.

"Like any true collector, you eventually realize you can't keep it all," she says.

With piles of beloved pieces in the basement of her mother's Crystal City house, Hill began renting space from an antiques cooperative in Falls Church when she was in college. It was a large building, with many vendors renting small stalls they did not have to staff personally—making it ideal for an absentee owner. The management of the cooperative took care of customers and their transactions.

Right from the start, Hill's business "paid for itself," she says. So Hill, with her savings in hand, left her job in 1995 to sell antiques. She began by working part time at her stall, hoping to turn the experience into a bigger business.

"It gave me a chance to work three or four days a week to learn what really makes people buy something," she says. Among her findings: People are just as interested in the practical use of an antique as in its provenance.

"Functionality is very important," Hill says—though people also want to know where the $45 Ironstone soup bowls came from and when they were made. She decided to focus her business primarily on small decorative and functional antiques, including some furniture, but carefully choosing items that would be in the price range of a wide assortment of buyers.

On her days off, Hill started doing more research on antiques, taking some continuing education classes on antique porcelain, furniture repair and textiles. She shopped to build up her inventory, and she wrote a business plan.

Then she went to SCORE.

Hill's grandfather, an entrepreneur in Omaha who worked as a SCORE volunteer, had told her about the program. As soon as she hooked up with Rosen, her ideas got traction.

Though never an entrepreneur himself, Rosen had founded and run the National Aeronautics and Space Administration's small-business program, counseling owners of small and disadvantaged companies so they could better bid on NASA contracts. He began volunteering for SCORE when he retired in 1994.

Hill's initial intention was to start her own cooperative and rent space to other dealers. The cooperative business had worked for her, she understood it and she thought she could run one. Rosen made her rethink that plan.

"I told her that if she were a real estate person, and knew how to do real estate, then it might work," Rosen recalls. "But when you're a landlord, it's very, very difficult. You have to have liability insurance and this and that, you have to provide water and restroom facilities, and she would not be able to attend to her primary business, which is antiques."

That was powerful advice that Hill followed. She and Rosen "clicked" right from the start, she says, and that chemistry was important in their mentoring relationship.

"A lot of it was his telling me his personal experiences," she says.

Rosen also helped Hill find a location half a block off Old Town Alexandria's main drag of King Street, and helped her with the lease contract. She opened in 1996.

Another SCORE counselor, retired retailer Herbert Robinson, stepped in to help Hill tweak her merchandising efforts.

Hill had always priced her goods by marking up her investment by a set amount. Robinson, though, told her she should mark some things up more and others less, depending on their inherent market value, which made Hill's business more profitable. He also taught her how to use codes on her stickers so she would know instantly what she had invested in a particular piece—important information to have at hand when a customer wants a price break.

At first, Hill lived on her savings and plowed all profits back into the business. But for two and a half years, she has been able to pay herself a salary, as well as benefits.

Hill still hunts for products whenever she can, sometimes closing the store to attend an auction. But much of Curzon Hill's merchandise is now brought directly to the store from people in the area. Some items Hill will buy outright and others she'll sell on consignment.

Hill's sales have quadrupled in four years, but the big growth lately has come from repairing and cleaning antique linens, which now accounts for 15 percent of her sales. She says retail sales will always account for the majority of her revenue, but hopes the growth of services will take her annual sales to about $100,000 in a couple of years.

Services are one of the few areas that Hill can expand, by hiring and training others to do the cleaning work. The store is more difficult to delegate to someone else, she has found.

"People invariably want to know where something came from," she says. "They want to talk to Sarah."

Which leaves Hill in her tiny shop five days a week, with her beloved cocker spaniel, Joshua, for company, surrounded by the antiques she wants so much for others to love as she does.

On a typical day, she'll sell $500 to $700 worth of merchandise, but that could be with as few as five customers, or as many as 30. The slow days are hard, and the busy days are exhilarating.

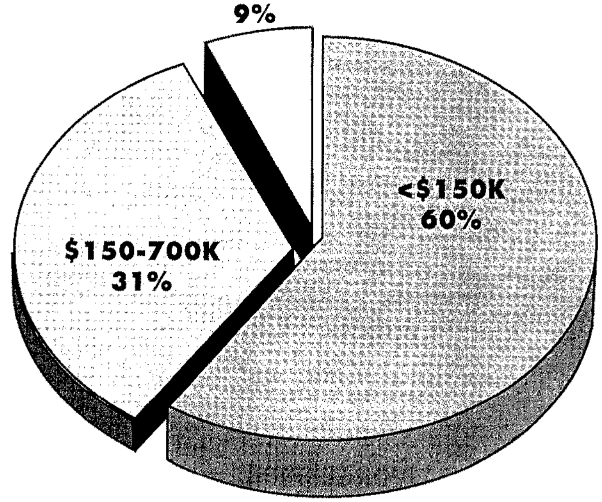
"That's what keeps it fun," she says. "Every day, you've got to wonder, is this going to be the $2,500 day?"

If you know about an interesting local entrepreneur or small business, send your suggestions to inbusiness@washpost.com. Margaret Webb Pressler delivers a morning business report each weekday on "News 4 Today," and writes a stock-market wrap-up every weekday morning on washingtonpost.com.

SBA
U.S. Small Business Administration

Approved 7(a) Loans, FY 2000

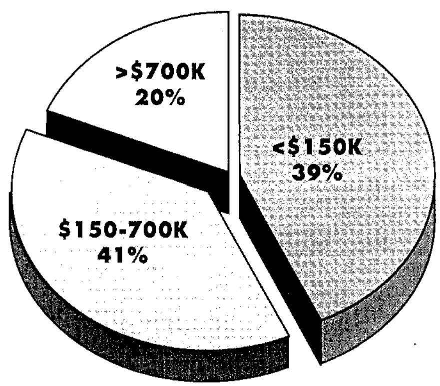
All 7(a) Loans



SBA
U.S. Small Business Administration

Percentage of 7(a) Loans Approved, FY 2000

To Asian Americans



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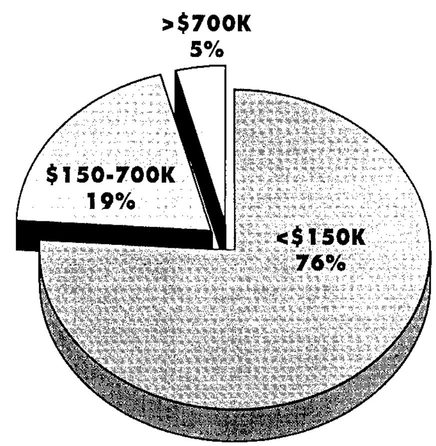
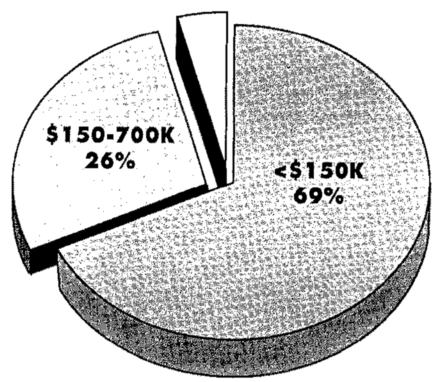


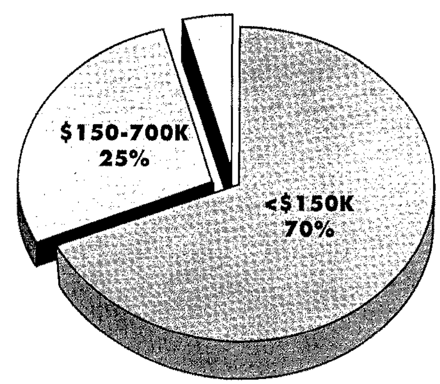
SBA
U.S. Small Business Administration

Percentage of 7(a) Loans Approved, FY 2000

To Women



To African Americans

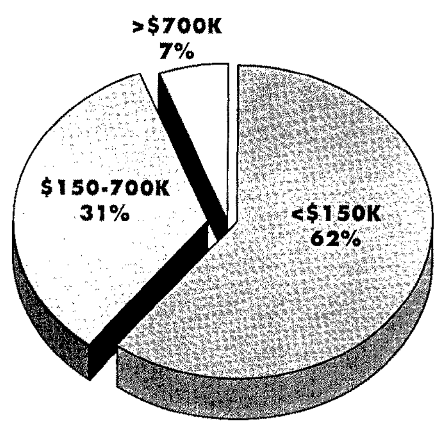


America's Small Business Resource

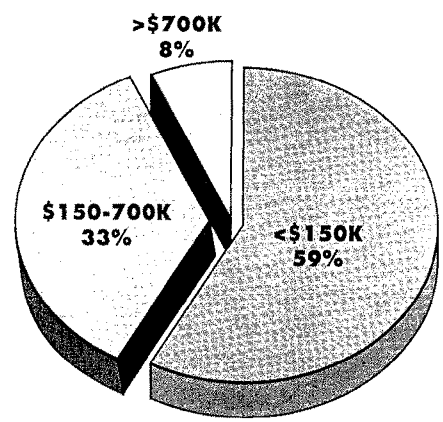
SBA
U.S. Small Business Administration

Percentage of 7(a) Loans Approved, FY 2000

To Hispanic Americans



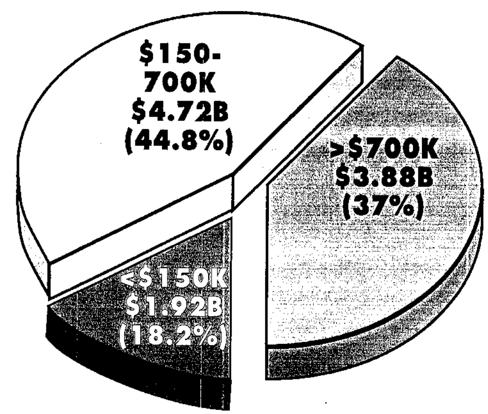
To Veterans



SBA U.S. Small Business Administration

Approved 7(a) Loans Dollars FY 2000

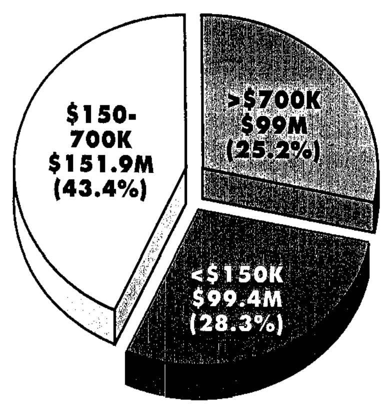
All 7(a) Loans



SBA
U.S. Small Business Administration

Approved 7(a) Loans Dollars FY 2000

To African Americans



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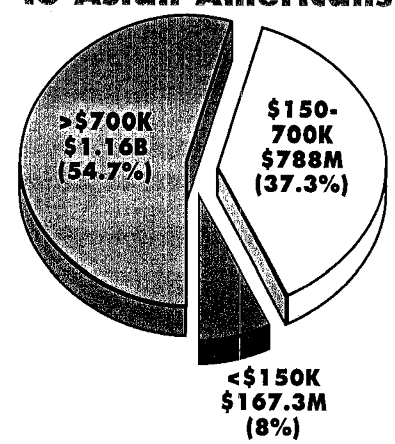
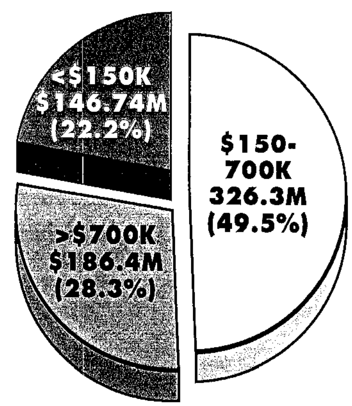


U.S. Small Business Administration

Approved 7(a) Loans Dollars FY 2000

To Hispanic Americans



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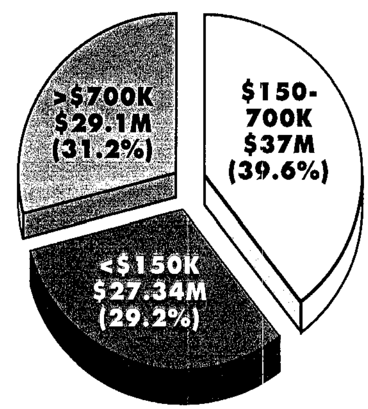
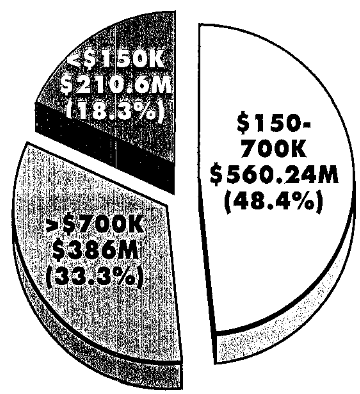


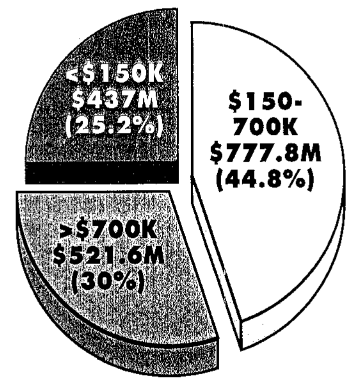
SBA U.S. Small Business Administration

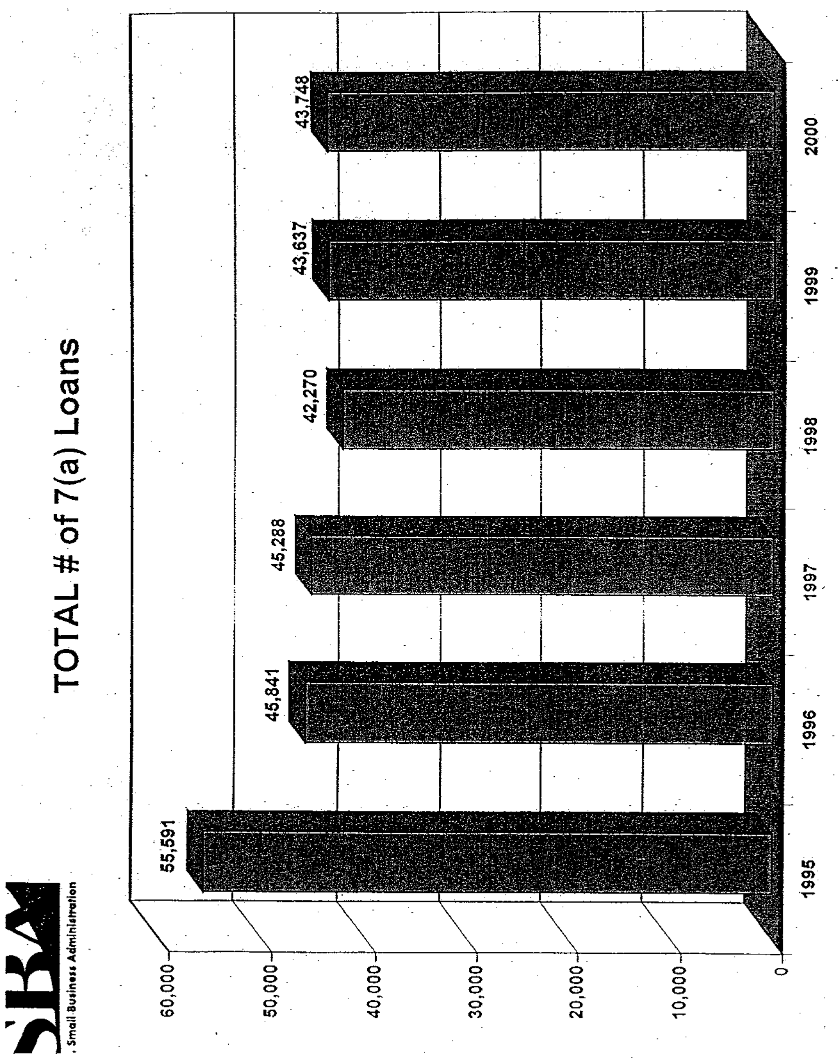
Approved 7(a) Loans Dollars FY 2000

To Veterans



To Women




SBA
Small Business Administration
TOTAL # of 7(a) Loans
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45,841
45,288
42,270
43,637
43,748
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1996
1997
1998
1999
2000
60,000
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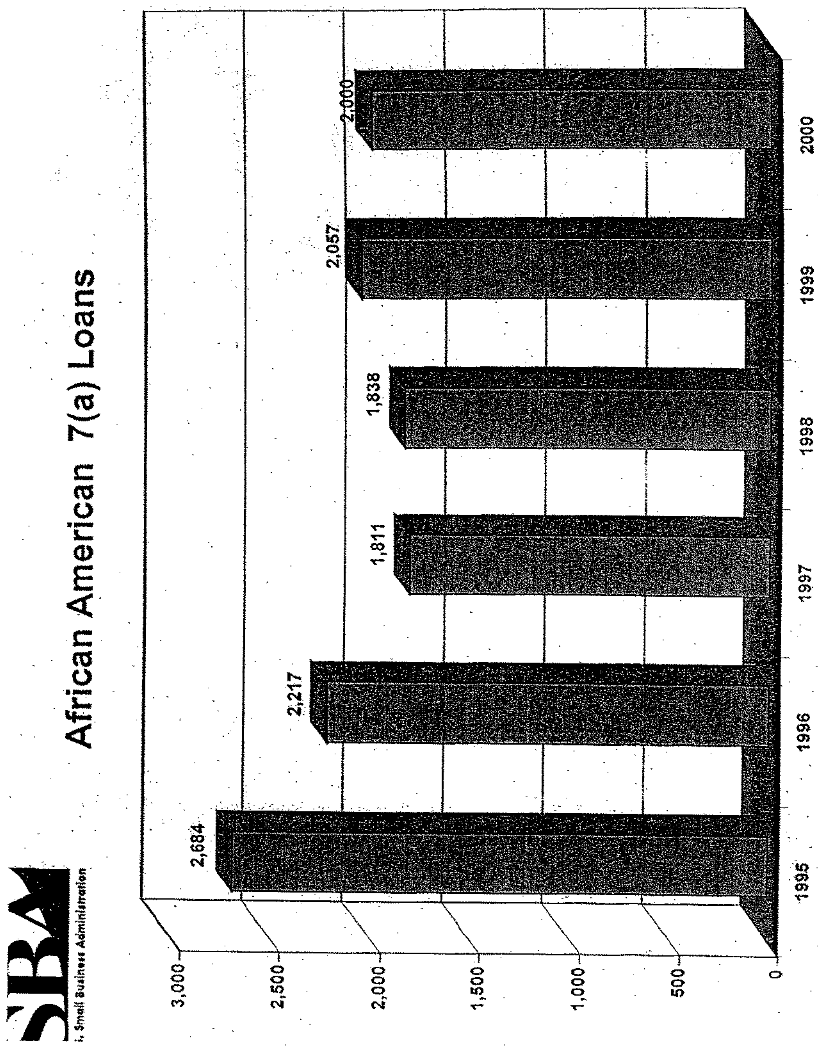
40,000
30,000
20,000
10,000
0


SBA
Small Business Administration
African American 7(a) Loans
3,000
2,500
2,000
1,500
1,000
500
0
2,684
2,217
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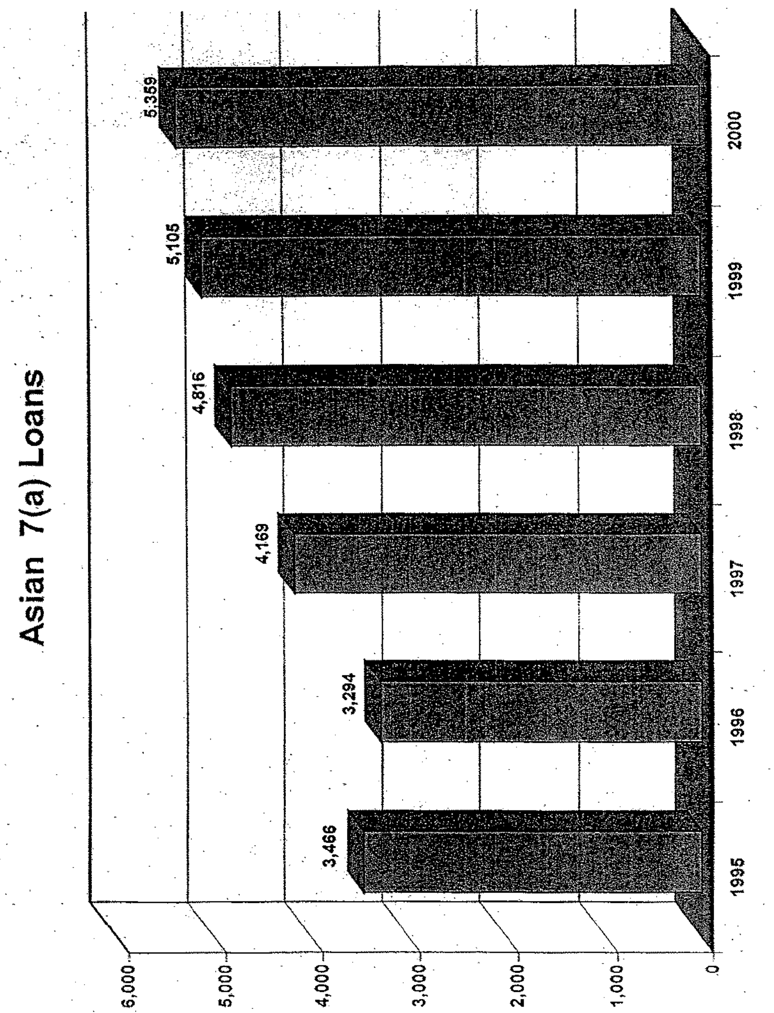
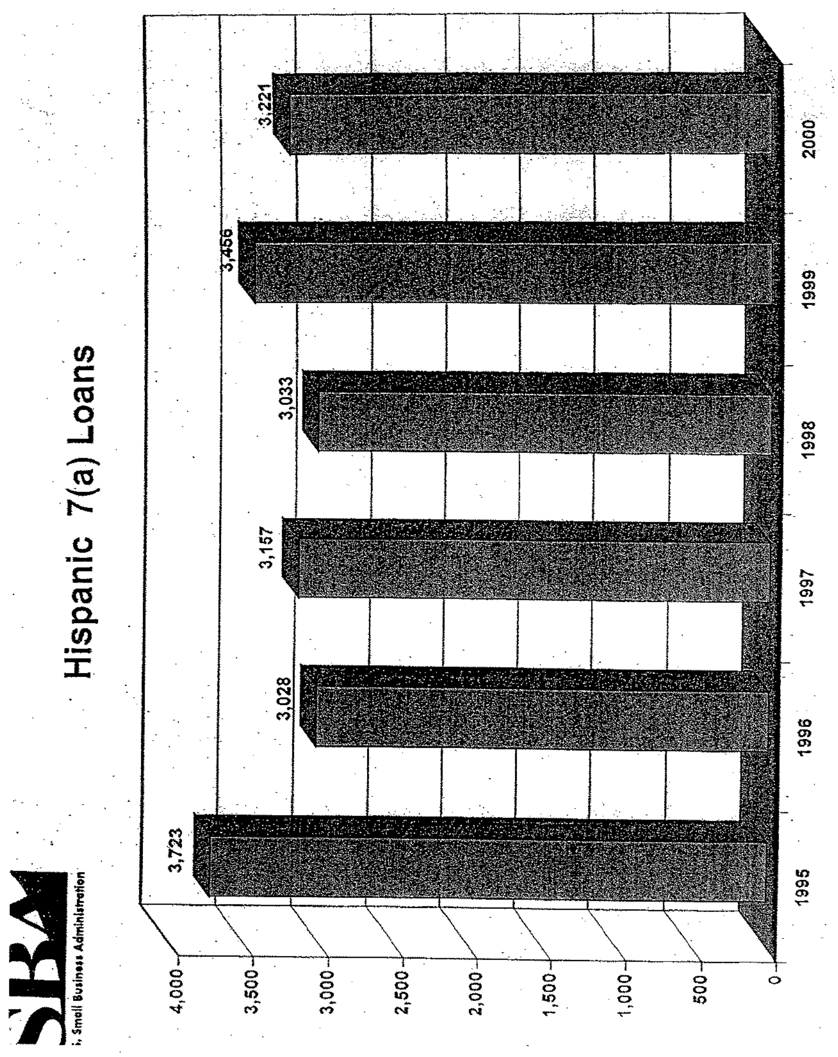
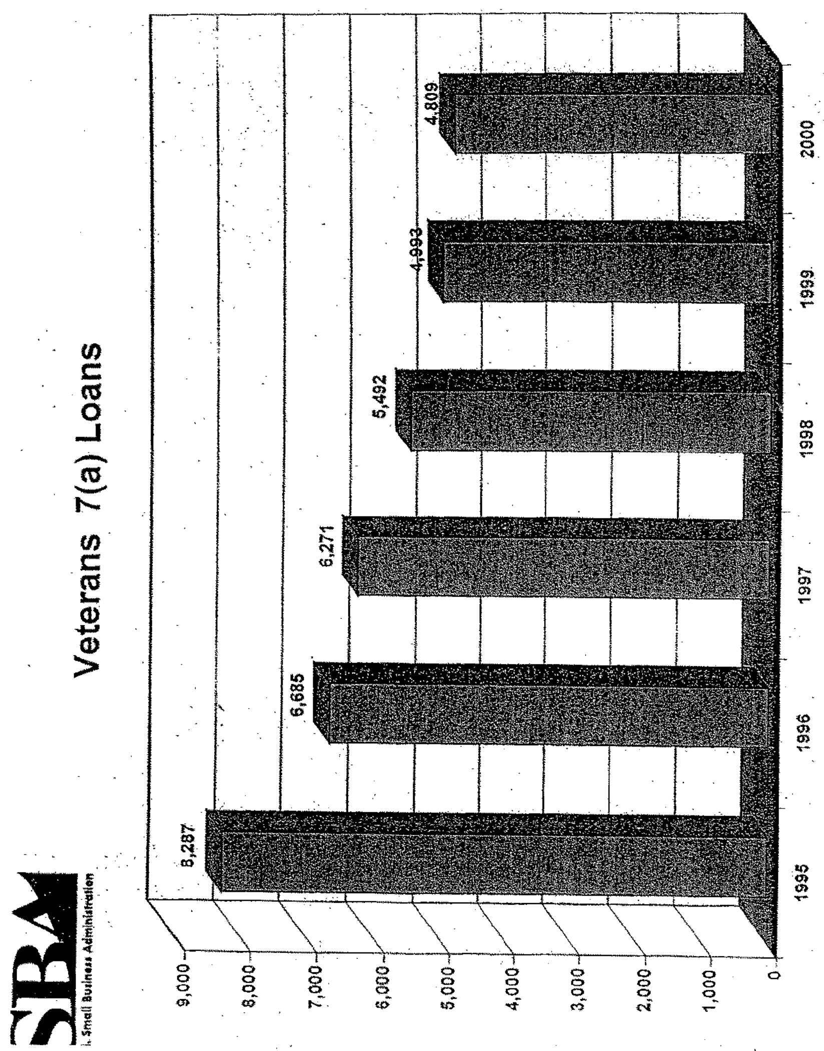
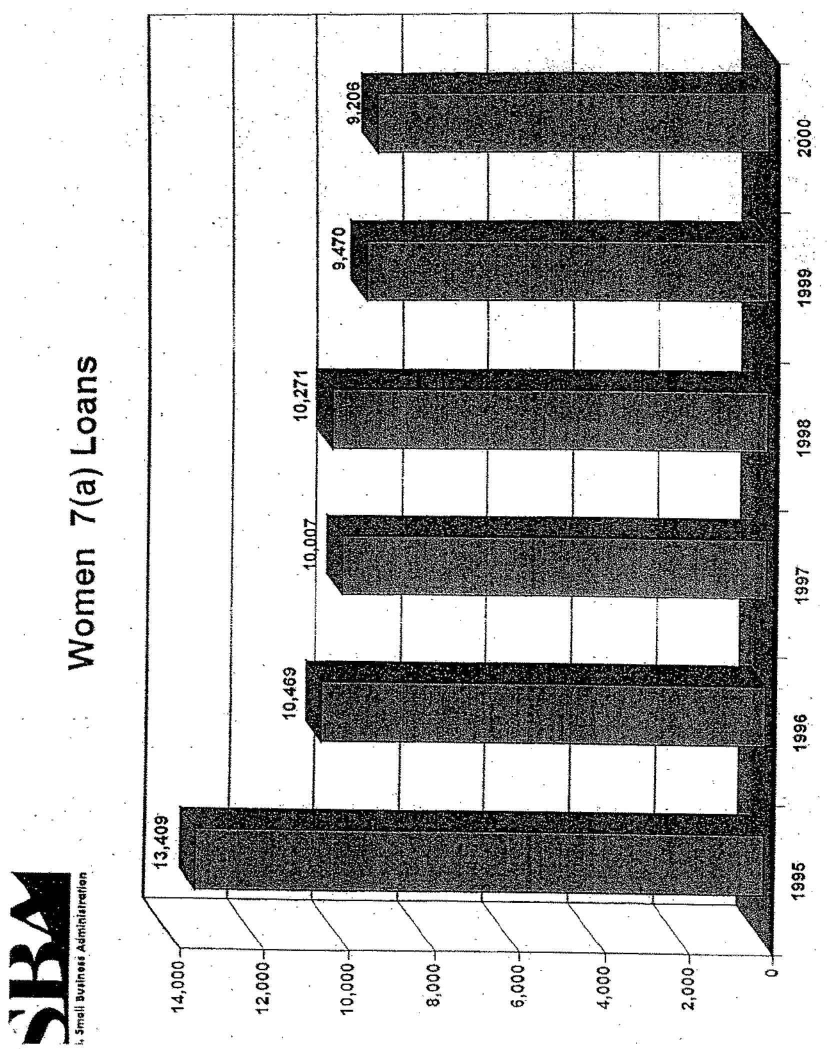
1,838
2,057
2,000
1995
1996
1997
1998
1999
2000


Asian 7(a) Loans
6,000
5,000
4,000
3,000
2,000
1,000
0
3,466
3,294
4,169
4,816
5,105
5,359
1995
1996
1997
1998
1999
2000

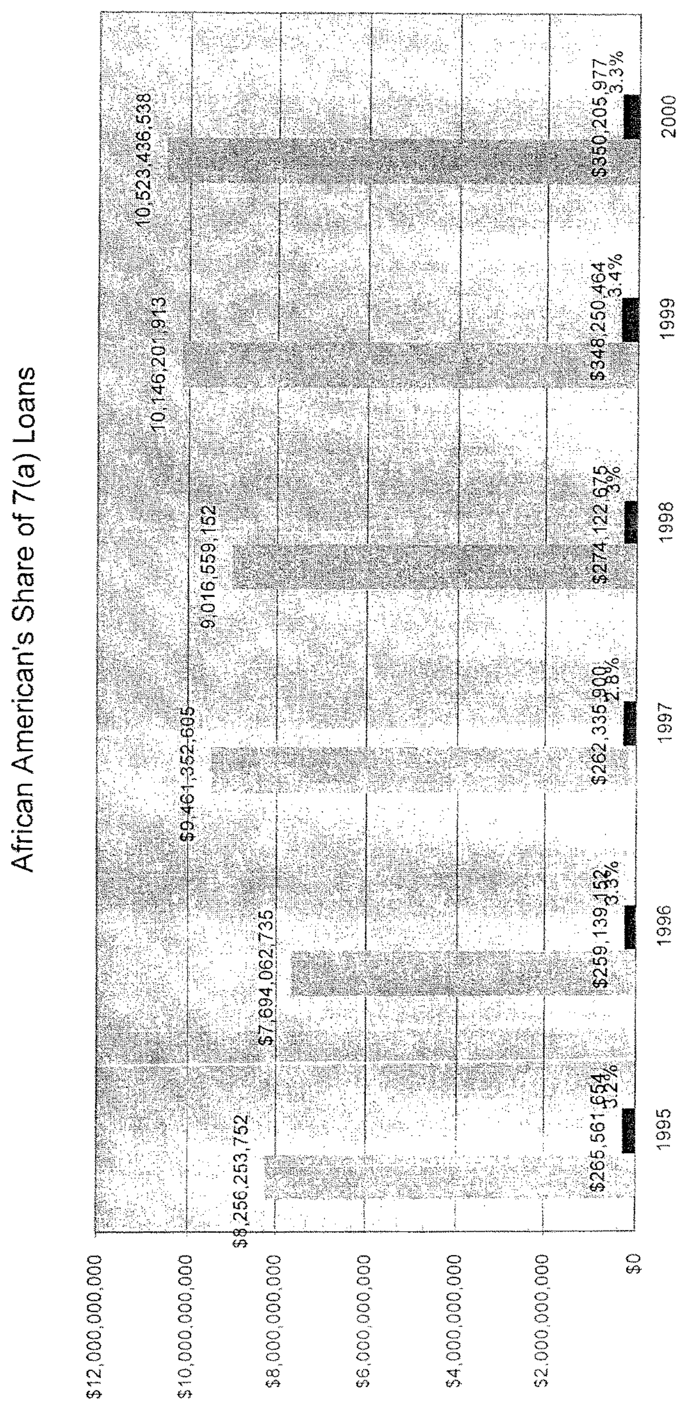


Hispanic 7(a) Loans
SBA
U.S. Small Business Administration
4,000
3,500
3,000
2,500
2,000
1,500
1,000
500
0
3,723
3,028
3,157
3,033
3,456
3,221
1995
1996
1997
1998
1999
2000

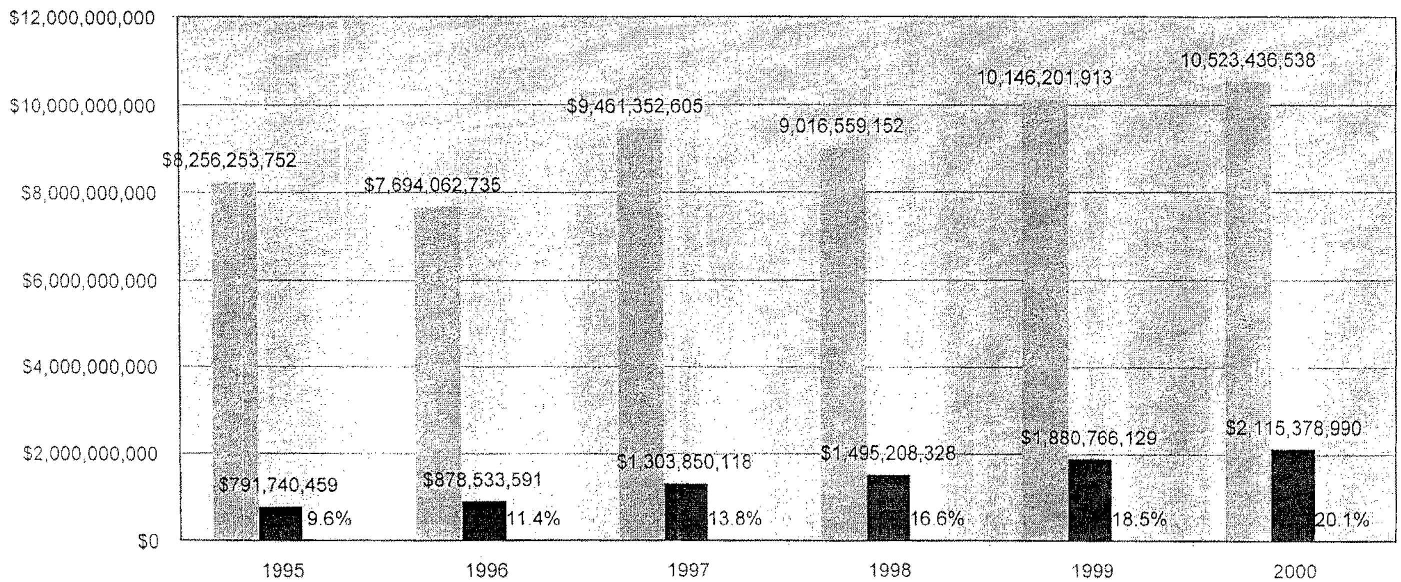

Veterans 7(a) Loans
U.S. Small Business Administration
9,000
8,000
7,000
6,000
5,000
4,000
3,000
2,000
1,000
0
8,287
6,685
6,271
5,492
4,993
4,809
1995
1996
1997
1998
1999
2000



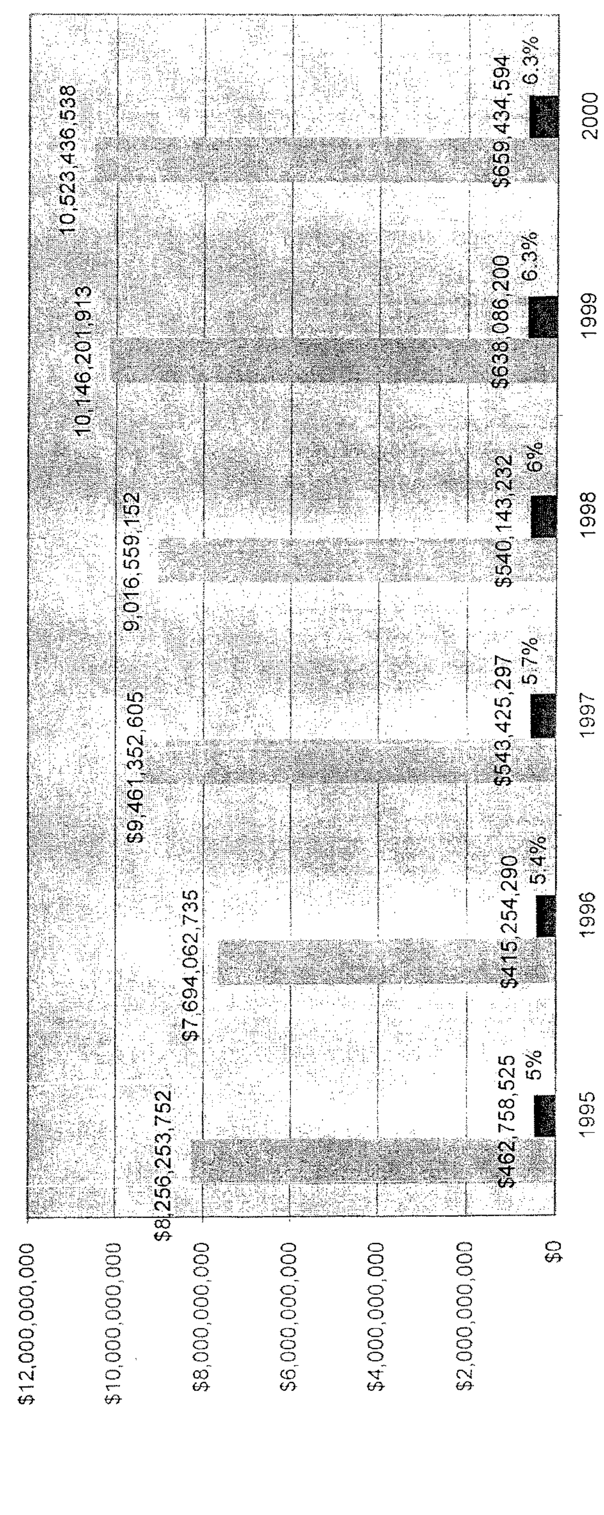
SBA
Small Business Administration
Women 7(a) Loans
14,000
12,000
10,000
8,000
6,000
4,000
2,000
0
13,409
10,469
10,007
10,271
9,470
9,206
1995
1996
1997
1998
1999
2000


African American's Share of 7(a) Loans
$12,000,000,000
$10,000,000,000
$8,000,000,000
$6,000,000,000
$4,000,000,000
$2,000,000,000
$0
$8,256,253,752
$265,561,654
3.2%
1995
$7,694,062,735
$259,139,152
3.3%
1996
$9,461,352,605
$262,335,900
2.8%
1997
9,016,559,152
$274,122,675
3%
1998
10,146,201,913
$348,250,464
3.4%
1999
10,523,436,538
$350,205,977
3.3%
2000

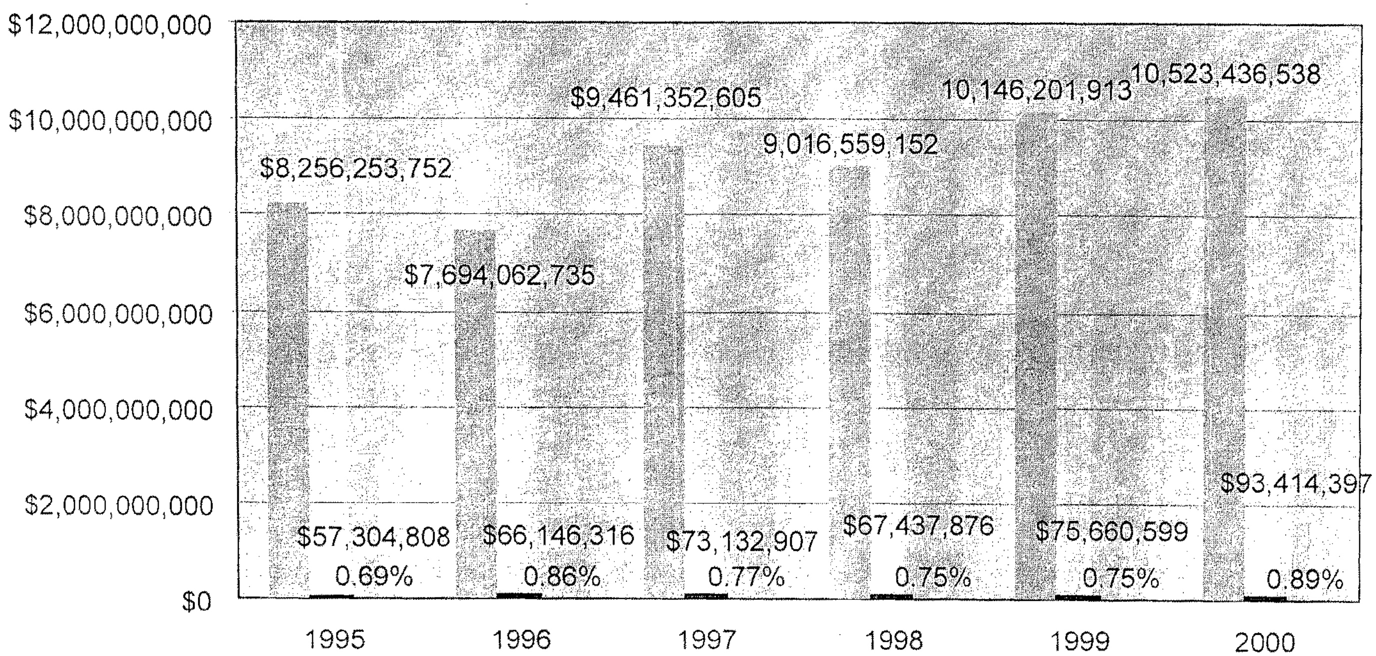
Asian American's Share of 7(a) Loans

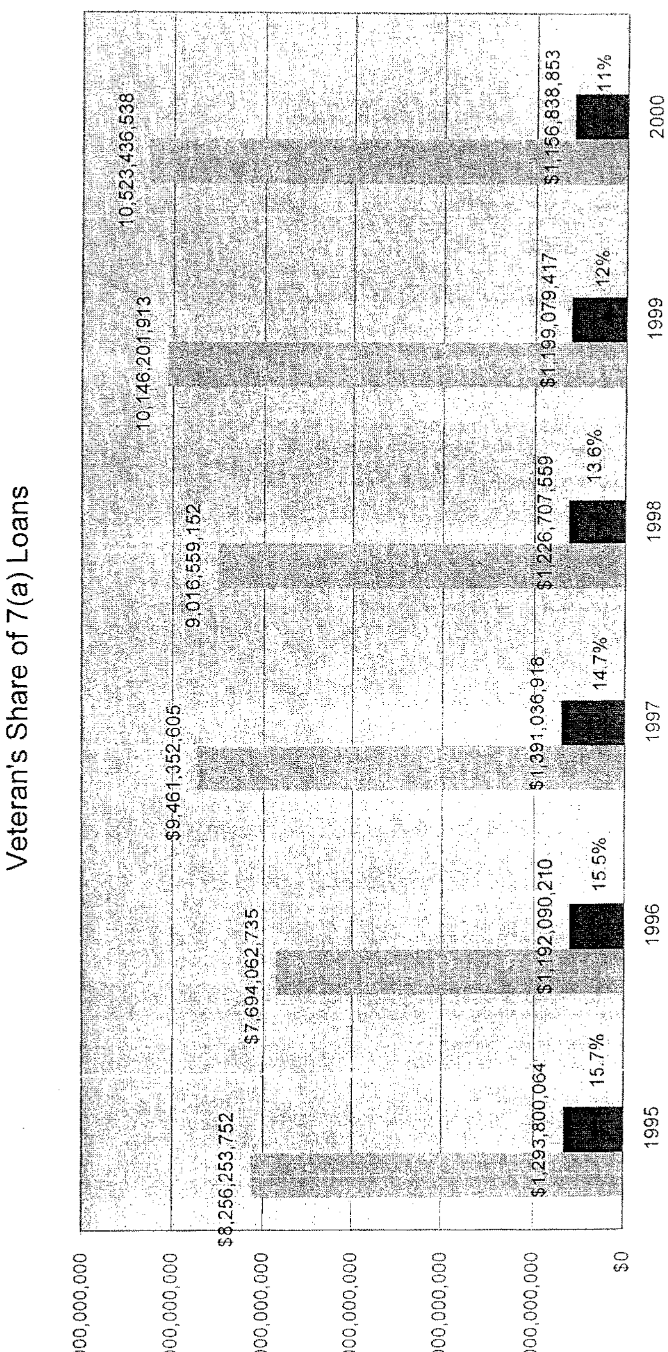


Hispanic's Share of 7(a) Loans



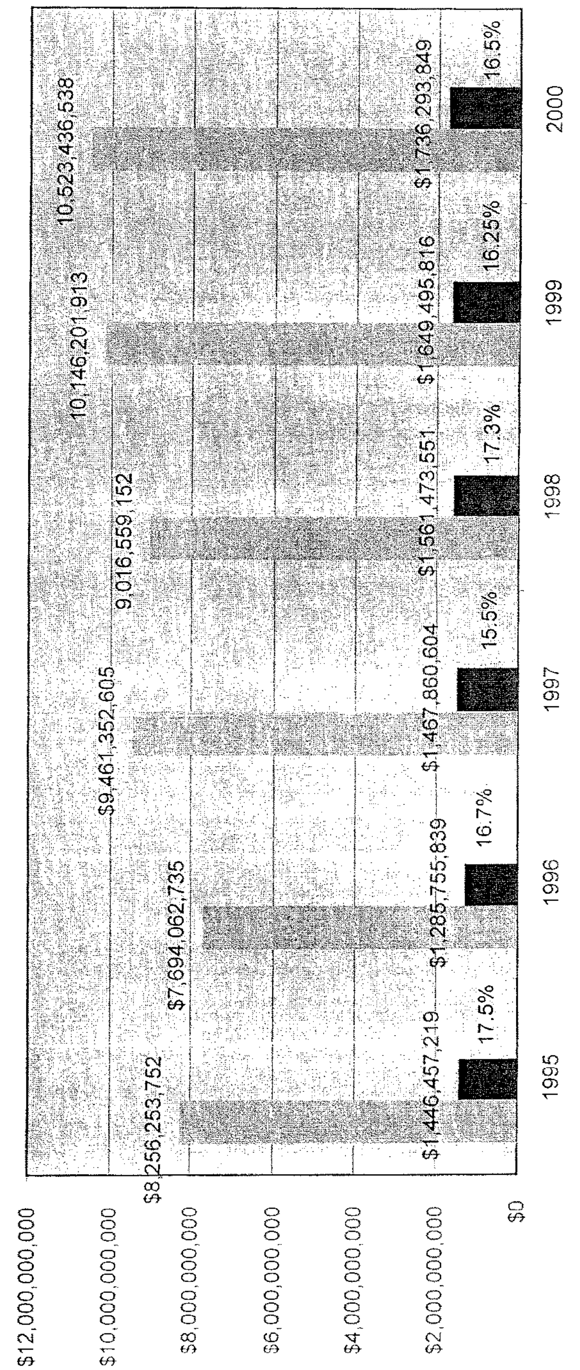
Native American's Share of 7(a) Loans





Veteran's Share of 7(a) Loans
$12,000,000,000
$10,000,000,000
$8,000,000,000
$6,000,000,000
$4,000,000,000
$2,000,000,000
$0
$8,256,253,752
$1,293,800,064
15.7%
1995
$7,694,062,735
$1,192,090,210
15.5%
1996
$9,461,352,605
$1,391,036,918
14.7%
1997
9,016,559,152
$1,226,707,559
13.6%
1998
10,146,201,913
$1,199,079,417
12%
1999
10,523,436,538
$1,156,838,853
11%
2000

Women's Share of 7(a) Loans



STATEMENT OF

DIANE WOLVERTON

STATE DIRECTOR

WYOMING SMALL BUSINESS DEVELOPMENT CENTER

REPRESENTING THE

ASSOCIATION OF SMALL BUSINESS DEVELOPMENT CENTERS

SBA's FUNDING PRIORITIES FOR FY 2002

BEFORE THE

COMMITTEE ON SMALL BUSINESS

UNITED STATES HOUSE OF REPRESENTATIVES

MAY 16, 2001

Chairman Manzullo, Ranking Member Velazquez, and Members of the Committee, I am Diane Wolverton, State Director of the Wyoming Small Business Development Center Program and Chairman of the Board of the Association of Small Business Development Centers (ASBDC). I am here today on behalf of the ASBDC which represents the SBDC programs in all fifty states, the District of Columbia, Puerto Rico, the Virgin Islands, Guam and American Samoa.

I would like to thank you Mr. Chairman and the members of this committee for inviting the ASBDC to testify at this hearing on the Small Business Administration's (SBA) Funding Priorities for FY 2002. I will restrict my comments to funding for the SBDC program and the attendant issue of imposing counseling fees on SBDC clients. With me today to assist in responding to any questions the committee may have, is Donald Wilson, President and CEO of the ASBDC.

At the outset of my remarks, I would like to express the appreciation of the ASBDC, its officers and members as well as the nearly 5,000 men and women who work in the SBDC program for the two decades of bipartisan support which the SBDC program has received from Congress. The ASBDC and the entire SBDC network want particularly to thank Chairman Manzullo for the Budget Views and Estimates letter which he sent last month to Chairman Nussle of the House Budget Committee, opposing the imposition of fees on SBDC clients for counseling services received and opposing a reduction in SBDC funding for FY 2002.

Let me quickly address the issue of charging fees for counseling as OMB and SBA have recommended. An estimated one-fourth of our service centers are located in targeted economic revitalization areas such as HUBzones, Empowerment Zones and Enterprise Communities. In these areas and nationwide, the imposition of fees would discourage many small business owners from seeking needed assistance from SBDC service centers. The charging of fees would radically change the relationship between client and counselor. Many small business owners who seek SBDC assistance do so because their businesses are in financial difficulty. Imposing counseling fees would defeat the very philosophy of government assistance on which this program is based. Just two years ago this committee recognized the adverse impact of imposing fees on struggling small business owners and pre-venture clients when a report of this committee stated that fees would "place the assistance of SBDCs out of the reach of many fledgling small businesses."

SBDCs delivered 1.36 million hours of counseling in FY 2000. The administrative costs associated with collections, billing, record keeping and fund transfers could amount to a significant percentage of fees collected. These costs and the corresponding increases in administrative staffing could discourage some SBDC host institutions from continued participation in the SBDC program

SBDC counseling clients, be they pre-venture clients or owners of existing businesses facing difficult economic times, will have a hard time understanding why they are singled out for "user fees" as OMB euphemistically describes them. Our clients will view the proposed new fees as simply another tax out of Washington. Our clients will not understand new fees being levied when most of the news out of Washington is about budget surpluses and tax cuts. They will also not understand why the SBDC network was the only SBA management and technical assistance program charging fees for counseling. The ASBDC and the entire SBDC network strongly urge this committee to remain firm in its historical opposition to imposing fees on SBDC small business and pre-venture counseling clients. We urge this committee to retain existing federal law prohibiting the charging of fees by SBDCs for counseling services.

Mr. Chairman, some have questioned why the ASBDC is advocating a substantial increase in the SBDC program budget for FY 2002 when the administration is trying to hold down the growth of federal spending.. The reason is simple. There is a compelling societal need for the services we provide. The Senate earlier this month recognized that need when by unanimous consent it approved an amendment to the Senate Budget Resolution offered by Senators Kerry and Bond providing for $105 million for the SBDC program in FY 2002.

During the last decade there has been a dramatic increase in entrepreneurship in this country. The Global Entrepreneurship Monitor (GEM), a joint research initiative sponsored by highly regarded Babson College, the Kauffman Center for Entrepreneurial Leadership at the Kauffman Foundation and the London Business School estimated last year that one in ten adult Americans was attempting to start a small business. Most of these aspiring entrepreneurs have no formal training in business management. The need for business management assistance and education is at unprecedented levels. This is due in part to the dramatic changes that have occurred in our economy spurred in large part by technology. This demand for business management assistance in a rapidly changing economy dominated by small businesses can only be expected to increase.

The Department of Labor recently reported that as unemployment levels rise, self-employment levels rise. Men and women who are laid off as the economy slows and young people who have difficulty finding employment frequently turn to self-employment as a means of providing for themselves and their families. Moreover, as the economy slows, credit contracts, revenues from sales fall and small businesses fall on hard times. Improved management practices can often help a small business owner survive a period of slow growth or an economic turndown. Entrepreneurial education can help an unemployed pre-venture client successfully start a business so that he can feed his or her family.

For months now the media has carried stories of major firms laying off large numbers of workers. SBDCs located near these facilities invariably experience increased demand for client services. Men and women who have lost their jobs frequently take their pensions and life savings and attempt to provide an income for their families by starting their own businesses. Many of these new entrepreneurs will fail. But many failures could be averted if the SBDC program, with its proven track record of success, had greater resources. Studies have confirmed that SBDC clients have a greater survivability rate than the average small business.

There is we believe a misperception by some that individual state SBDC programs have experienced significant funding growth in recent years. The fact is that the national program has experienced average growth of only about 3% per year. But that is not a reflection of what has occurred in most states. Last year, this Committee recommended and Congress approved an authorization level of $125 million for the SBDC program for FY 2001, 2002 and 2003. The FY 2001 SBDC national program appropriation was less than $88 million. Federal funding for the SBDC program in Chairman Manzullo's and Representative Davis' home state of Illinois was $ 3,280,500 in 1991. This year the federal funding for the Illinois SBDC is $3,602,452. That is an increase of $330,157 in ten years, a total percentage increase of just over 9.8 % in a decade. By comparison the nation's economy grew by better than 43% from 1994 to 2000, federal revenues grew by a remarkable 56 % and inflation increased by roughly 20% in the last decade.

The SBDC program in Pennsylvania, the home state of Representatives English, Toomey and Brady received $ 3,403,999 in 1991. In FY 2000 Pennsylvania's funding had grown to $3,455,203. That represents a total increase in federal funding of 1.5% over nine years. This year the SBDC in Missouri, home to Representatives Graves and Akin will receive federal funding in the amount of $ 1,614,145. That represents a total increase of $92,739 or 6 % over nine years.. Roughly 70% of state SBDC programs have experienced federal funding growth at levels roughly half the rate of inflation over the last decade. Clearly, state program growth levels of this size are inadequate to meet the needs of a burgeoning small business community. I believe members of the Committee can appreciate that fact with the realization that an estimated 1,200 new SOHO (Small office/ Home office) businesses formed every hour of every business day last year.. And, it is estimated that nearly 51 million SOHO businesses could be established by 2002.

To be objective, I want to point out that overall SBDC national program growth exceeded the percentages I have just outlined for a number of typical states. However, a significant share of the overall program growth went to a number of states with very low population density and often large square mileage such as my state of Wyoming, as well as Montana, Idaho, Alaska, Nevada. North and South Dakota, Utah, etc. Congress, with the full support of the ASBDC, provided that there would be a minimum program level of $500,000 per state regardless of population. This policy enabled SBDC programs in sparsely populated states to meet the Congressional mandate of state wide geographic coverage and to meet the needs of those states' citizens. As a result, funding for my state of Wyoming has increased very significantly in percentage terms in the past decade.

Last fall, Mr. Chairman, the SBDC program celebrated the 20th anniversary of the signing of Public Law 96-302. Title II of that Act was the Small Business Development Center Act of 1980. Last year, the historical total of SBDC counseling clients surpassed 3,000,000 and the historical total of combined counseling clients and training attendees surpassed 8,000,000. During FY 2000 alone, the SBDC program provided face to face counseling and training to nearly 600,000 small business owners and pre-venture clients. Informational services were provided to hundreds of thousands of additional clients. And this was during a year of strong economic growth.

Those of us who manage the program on a day-to-day basis are proud of the SBDC program's proven record of cost effective delivery of management and technical assistance to the nation's small business community. That is why we were so disappointed to learn earlier this year that

OMB was recommending a $12 million cut in the SBDC program and the imposition of "user fees" on SBDC clients. This recommendation was all the more difficult to understand when President Bush in his first address to a joint session of Congress on February 27th stated so eloquently that "Help for small businesses means jobs for Americans." The SBDC program is proof of that fact. Firms that receive SBDC counseling add employees at a rate significantly higher than the average U.S. business.

Members of this committee are well aware of the fact that small businesses with fewer than 20 employees have been responsible for roughly 70% of the net new jobs created in the American economy in the last decade. Small businesses with fewer than 500 employees employ 53 % of the private non-farm workforce. They contribute 47% of all sales and are responsible for 51% of the Gross Domestic Product. And yet, despite the fact that small businesses have contributed so significantly to the economy and to the growth of federal revenues, (growth that has enabled Congress to balance the budget and begin to pay down the national debt), the federal government is allocating a tiny fraction of its resources to assist small businesses.

The most recent Chrisman Study found that <u>additional</u> federal tax revenues generated by SBDC long term counseling clients alone exceeded $214,000,000. That is two and a half times the amount of federal funds the entire program receives. Clearly, the SBDC program is a program that more than pays for itself. Cutting resources to state SBDC programs will almost assuredly mean increased business failures, layoffs of small business employees, increased unemployment payments, disability payments, food stamp payments, small business loan defaults, etc. ASBDC believes that OMB's static analysis asserting that reducing SBDC program funding by $12 million will result in $12 million in budget savings is seriously flawed.

In considering an appropriate funding level for the SBDC program for FY 2002, it is important to consider another factor other than the counter cyclical nature of the demand for program services and the fact that program funding has not kept pace with the increase in business startups or the cost of living over the past decade. It is vitally important to realize that as a result of the latest census, 41% of state SBDCs in FY 2002 will suffer significant program cuts even at so-called level funding of $87.8 million. These states will see sharp reductions of their SBDC programs at a time when small businesses need SBDC services the most. For example, **at level funding for the national SBDC program of $87.8 million,** the Illinois SBDC will suffer a cut of approximately $140,000, New York will suffer a cut of over $380,000, New Jersey will suffer a cut of nearly $ 90,000, Ohio will suffer a cut of over $ 255,000, Missouri will suffer a cut of over $ 55,000, Indiana will suffer a cut of approximately $ 53,000, New Mexico will suffer a cut of over $ 40,000, Arkansas will suffer a cut of nearly $ 40,000, Oklahoma will suffer a cut of over $ 45,000, West Virginia will suffer a cut of $ 145,000 and Maryland will suffer a cut of over $ 30.000.

At the SBA recommended level of $75.8 million in federal funds for the national SBDC program, these cuts would be sharply magnified and states like Rhode Island, and South Dakota and the Virgin Islands would also face significant cuts. I am confident that program service cuts of this magnitude are not the message that Congress and this Administration want to send to the nation's small business community at the very time that millions of small businesses are struggling to survive.

As a nation we have prospered over the last decade. However, ASBDC and the SBDC network recognize that not all Americans have shared equally in the increased prosperity that the nation has enjoyed during the nineties. ASBDC and the SBDC network have historically been committed to helping open doors of economic opportunity for individuals who may have been disadvantaged.

During FY 2000, almost 43 % of our counseling and training clients were women and 31% of counseling clients were minorities. SBDC outreach programs to minority communities such as the Connecticut SBDCs outreach to the Hispanic community have generated considerable and justified media attention. Your colleague, Representative Nancy Johnson, can testify to the success of Connecticut's program. The network is proud of its outreach programs to veterans. For example, SBDC veterans outreach programs in Minnesota recently were recognized for their excellence. Personnel from two centers were named SBA Veterans Advocates of the year for their veterans outreach programs, particularly with disabled veterans.

Mr. Chairman, there is nothing comparable to the service infrastructure that the SBDC program has built using and leveraging the federal dollars that we have received over the past twenty years. The federal dollars received, coupled with the matching dollars we are required to raise hav enabled the SBDC program to develop the current nationwide network of approximately 1,000 full time service centers employing approximately 5,000 service providers. We believe the SBDC network is the most cost-effective resource that Congress can utilize to deliver essential business management education to existing and aspiring entrepreneurs.

The program has developed over 3,400 strategic resource partners including educational institutions, lending institutions, economic development agencies at the state and local level, Chambers of Commerce, etc. This infrastructure and its partnerships are unmatched and would take decades and enormous financial resources for any other program to replicate. The value of this infrastructure was never more apparent than in October of 1999 when Hurricane Floyd, the worst natural disaster in North Carolina history struck Eastern North Carolina. The state and federal efforts to assist small business owners devastated by Hurricane Floyd were dramatically enhanced as a result of the mobilization of the personnel and utilization of the expertise of the North Carolina Small Business and Technology Development Center. SBDCs in other states, North Dakota and South Carolina for example, have provided critical assistance when natural disasters struck their states

The SBDC program does not just help individual business owners. It helps communities. Some of you may be aware of the commendations that former President Carter has directed toward the SBDC program for the assistance the Georgia SBDC has provided his hometown of Plains, Georgia. You should also be aware of events in the City of Parrott in Terrell County Georgia. In 1995, the downtown area of Parrott no longer had any businesses at all. Property owners asked a Georgia SBDC consultant for help in recruiting new businesses. With the help of the SBDC consultant, a detailed plan was developed establishing a local financing pool and implementing a business recruitment effort. Downtown Parrott now has 18 new businesses, has created 50 jobs and draws customers from across southwest Georgia and Alabama. Governor Barnes recently cited Parrott as an outstanding example of what local people in rural communities can do to help themselves.

The ASBDC and its membership are proud of real life success stories such as those just mentioned. We are also proud of the dramatic efforts we have made in the last two years to train SBDC personnel in how to address the technological issues of the "New Economy" thereby enabling the program to provide clients with the knowledge to utilize and cope with changing technologies. The SBDC program is now increasingly well positioned to assist small technology companies. We are also proud of our use of technology such as real time distance learning initiatives and other programs to better reach outlying communities.

Several SBDCs such as those in Nevada, Pennsylvania, Vermont, New Hampshire, Maine, Kentucky, and Illinois have earned well deserved reputations for their efforts in providing business clients with badly needed environmental regulatory compliance assistance. And SBDC

International Trade Centers are helping thousands of small businesses to become exporters, thereby strengthening the economy by improving our balance of trade.

And we are proud of our continuing effort to improve the overall quality of the SBDC program. The Congressionally mandated SBDC Certification Program distinguishes the Small Business Development Center program from all other government supported business service initiatives. The goal of the certification program is to ensure consistent quality service delivery throughout the entire SBDC network. Failure by a state SBDC program to pass certification can result in the loss of federal funding. ASBDC and its members are constantly seeking to improve the certification program. In the last twelve months the ASBDC certification committee has moved aggressively to incorporate the Malcolm Baldrige total quality management methodology into the certification program.

In summary, the SBDC program is the federal government's largest and most successful small business management and technical assistance program. We have an established, proven infrastructure without peer. We have a documented track record of responding to the needs of the communities and clients we serve. Our clients represent the face of those communities, including rural and urban populations, minorities, women and Native Americans. We currently assist roughly 600,000 small business clients annually. The SBDC network is well positioned to deliver effective management and technical assistance services to a significantly expanded client base if provided the resources to do so by Congress. This is a commitment we can and do make to this committee today.

NAGGL

The Answers You Trust
The Training You Expect
The Voice You Need

Testimony for the House Committee on Small Business

Anthony R. Wilkinson,
President and Chief Executive Officer

The National Association of
Government Guaranteed Lenders, Inc.

P.O. Box 332
Stillwater, OK 74076-0332

Wednesday, May 16, 2001

The National Association of Government Guaranteed Lenders, Inc. ("NAGGL") is a trade association for lenders and other participants who make approximately 80 percent of the Small Business Administration ("SBA") section 7(a) guaranteed loans. The SBA's 7(a) guaranteed loan program has proven to be an excellent public/private partnership. Since the program's inception, the SBA has made or guaranteed more than 600,000 loans totaling approximately $80 billion. We thank the Committee for the opportunity to comment on the SBA 7(a) program.

NAGGL requests support for an appropriation of $118 million for the SBA 7(a) program in FY 2002. Although this represents a decrease in appropriations from the current year, it, nevertheless, would fund a growing program. The current year's appropriation would fund about $10.4 billion in 7(a) loans. Next year, we estimate demand of $11 billion. Yet, less appropriations would be needed in FY 2002 as a result of the OMB-determined SBA 7(a) subsidy rate declining from the FY 2001 rate of 1.17 to 1.07 for FY 2002.

Since the beginning of "Credit Reform" in 1992, the SBA 7(a) subsidy rate has fallen from a high of 5.21 to the projected current services level for FY 2002 of 1.07. This represents an 80% reduction in the estimated cost of the program to the government. This reduction in subsidy costs has been achieved by improved underwriting guidelines, establishment of lender review procedures, and fee increases on both borrowers and lenders.

There are many positive attributes of the SBA 7(a) loan program, including:

- SBA loan programs provide as much as 40% of all long-term loans (loans with maturities of three years or longer) to small businesses.

- SBA 7(a) loans have significantly longer maturities than conventional loans to small businesses. The average original maturity of SBA 7(a) loans, according to the Office of Management and Budget ("OMB"), is 14 years. By comparison, only 16% of conventional small business loans have maturities in excess of one year, and of those loans, the average maturity is less than four years

- Longer maturities mean substantially lower monthly payments for borrowers. For example, the difference in monthly payments from a 10 year SBA 7(a) loan to a five year conventional loan (which would be above the average maturity for conventional loans), would be 35-40%. This is a significant increase for the average SBA borrower who tends to be a new business startup or an early stage company.

- Small businesses do not have the same access to capital as do large businesses. The SBA programs bridge that capital gap. Banks can not be expected to make long-term loans, the kind most needed by small business, when banks are funded by a short-term deposit base.

- The SBA 7(a) appropriations are leveraged almost 99 to 1 by the private sector, making this one of the governments' best economic development instruments. With a more accurate subsidy rate estimate (as discussed below), the leverage ratio would be even higher.

- The SBA 7(a) loan program is just that – a loan program – which helps qualified small businesses obtain the long-term capital they need for growth and expansion. This means jobs, and a "net return on investment" for our local communities and the US Treasury.

Unfortunately, the Administration's budget request for FY 2002 for the SBA 7(a) loan program calls for further increases on both borrowers and lenders. The Administration proposes to reduce the subsidy rate from the FY 2002 current services level of 1.07 to zero. In reviewing the past performance of the SBA 7(a) loan program, fee increases simply are not justified. In addition, a recent NAGGL survey of SBA 7(a) lenders indicated that the use of the 7(a) program would be greatly diminished if fees were increased.

For instance, for loans approved from FY 1992-1998, Congress appropriated approximately $1.4 billion for subsidy budget authority. When looking at those loan cohorts, already approximately $1.25 billion has been returned to the Treasury through "subsidy re-estimates." This means OMB has substantially over-estimated the cost of the 7(a) program. NAGGL believes that the SBA 7(a) program subsidy rate is far less than the subsidy rate currently estimated by OMB.

In testimony before the House Small Business Committee just last year, an SBA official testified that the estimated default rate for the SBA 7(a) loan program was "in the 8%-10% range." Yet OMB requires the use of an approximate 14% default rate in the subsidy rate calculation. Each 1% reduction in the default estimate would reduce the subsidy rate by approximately 34 basis points, or .34. If the highest SBA default estimate of 10% (per the House testimony last year) were used, the current subsidy rate of 1.17% would be reduced by over 120 basis points. This would mean that the subsidy rate today is already below zero.

At the same House Small Business Committee hearing last year, the former SBA Administrator testified "the program is already being run at a profit to the government." There is clearly no justification whatsoever to increase program costs on SBA 7(a) program participants.

It is especially noteworthy that the leadership of both the Senate and House Small Business Committees have agreed with our assessments. In a letter to the Chairman and Ranking Member of the Senate Budget Committee dated March 16, 2001, Senate Small Business Committee Chairman Christopher Bond wrote:

> *"The small business community is dependent on the SBA 7(a) program to obtain long-term financing at a competitive interest rate. Each year, 40,000 or more small business concerns, who cannot obtain credit elsewhere, turn to the 7(a) program for critical financing. Currently, both the borrowers and lenders pay significant fees to the SBA to help offset the credit subsidy cost necessary to underwrite the program. The Fiscal Year 2002 budget request seeks to increase the fees paid by borrowers and lenders to offset the need for an annual appropriation. The net result of the Administration's budget would be to drive both the small business borrowers and the lenders from the program. I do not believe it is the intention of the Administration, nor is it the intent of Congress, to deny needed business loans to small business borrowers at the same time the economy is slowing and credit underwriting standards have tightened significantly. Therefore, I strongly recommend that $118 million be added to the Business Loan Account of the SBA Fiscal Year 2002 budget to support an $11 billion 7(a) loan program."*

Likewise, the Ranking Democrat on the Senate Small Business Committee, Senator John Kerry introduced an amendment to the Senate budget resolution that would restore FY 2002 funding for the SBA 7(a) program. Senator Bond and several other Senators, both Republican and Democrat, co-sponsored the legislation that passed the Senate under unanimous consent. A copy of the Senate Small Business Committee news release is attached.

In a letter to the House Budget Committee dated March 14, 2001, House Small Business Committee Chairman Donald Manzullo writes:

"Previous reports from the General Accounting Office (GAO) indicate the subsidy costs have been inflated. OMB re-estimates of the subsidy cost of the 7(a) program consistently show execution rates are inflated. This has the potential to lead to the overcharging of small business borrowers. As the U.S. economy enters a period of zero growth and perhaps even a recession, the Committee is also concerned about the effect of these proposed heightened fees on the availability of capital to small businesses.

The proposed increase in 7(a) fees, despite improvements in purchases and recoveries, continues to raise concerns in the Committee. Inaccurate subsidy costs will result in overpayment of fees and eliminate flexibility in program delivery. The Committee believes that the 7(a) program is already operating at or near a zero subsidy rate and the President's budget request should instead contain a one-time accurate accounting change to reflect that reality. Thus, there should not be a need to increase fees."

Importantly, the Administration's budget request recognizes that the proposed fee increase could have a detrimental impact on small businesses. Included in the budget narrative is the following:

" *The Administration's fee proposal acknowledges that some small businesses may have trouble accessing capital..."*

Yet in the analytical perspectives section of the budget (page 150), the Administration further states:

"Traditionally, small firms have faced difficulty obtaining long-term loans in the private market place because they tend to have limited credit history and cash flows. SBA's role as a 'gap' lender is to correct these market imperfections and provide credit access during economic downturns."

NAGGL requests your support for $118 million in FY 2002 appropriations for the SBA 7(a) program. We urge you to make sure there remains a viable, usable SBA 7(a) loan program by rejecting any further fee increases, and supporting sufficient appropriations to support an $11 billion SBA 7(a) loan program for FY 2002. Additionally, NAGGL requests that the Small Business Committee request an independent review of the assumptions used by OMB in the 7(a) subsidy model.

Thank you for the opportunity to testify before the Committee.

NEWS RELEASE

United States Senate
Committee on Small Business

Christopher S. "Kit" Bond, Chairman

FOR IMMEDIATE RELEASE

April 6, 2001

CONTACT:
Craig
Orfield
(202) 224-
5175

SENATE UNANIMOUSLY APPROVES $264 MILLION BOOST TO SBA PROGRAM FUNDS, BOND SAYS

(Washington) - Senator Kit Bond said today the Senate has approved an amendment to the Budget Resolution that will boost funding for key small business programs, including 7(a) guaranteed loans, HUBZones, Small Business Development Centers and Women's Business Centers. The amendment was accepted by unanimous consent Friday.

"This is the first step to ensure that the most vital SBA programs, which have helped sustain solid growth in the small business sector for years, will be adequately funded in the Fiscal Year 2002 Budget," Bond said Friday. "These are the core SBA programs, which have earned a solid record for sustaining our nation's main street. With a slowing economy, Congress simply cannot afford to ease up on the throttle fueling these programs.

"Later this year, I will continue working with my colleagues to secure hard earmarks for these core SBA programs in appropriations bills for FY 2002," he added. "America's small businesses can rest assured that I am committed to completing this process."

Bond, Chairman of the Senate Committee on Small Business, co-sponsored the amendment with Senator John Kerry, Ranking Member of the Committee, to increase budget authority for SBA programs by a total $264 million. The increase would restore the bulk of a recommended 40 percent reduction in SBA program funding.

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Credit accounts—Continued

BUSINESS LOANS PROGRAM ACCOUNT—Continued

Program and Financing (in millions of dollars)—Continued

Identification code 73–1154–0–1–376		2000 actual	2001 est.	2002 est.
	Unpaid obligations, end of year:			
74.40	Unpaid obligations, end of year	88	124	63
74.99	Obligated balance, end of year	88	124	63
	Outlays (gross), detail:			
86.90	Outlays from new discretionary authority	190	185	83
86.93	Outlays from discretionary balances	88	125	109
86.97	Outlays from new mandatory authority	5		
87.00	Total outlays (gross)	283	310	192
	Net budget authority and outlays:			
89.00	Budget authority	264	328	131
90.00	Outlays	283	310	192

Summary of Loan Levels, Subsidy Budget Authority and Outlays by Program (in millions of dollars)

Identification code 73–1154–0–1–376		2000 actual	2001 est.	2002 est.
	Direct loan levels supportable by subsidy budget authority:			
1150	Micro loans	27	34	21
1159	Total direct loan levels	27	34	21
	Direct loan subsidy (in percent):			
1320	Micro loans	8.54	8.95	6.78
1329	Weighted average subsidy rate	8.54	8.95	6.78
	Direct loan subsidy budget authority:			
1330	Micro loans	2	2	2
1330	Subsidy reestimation		1	
1339	Total subsidy budget authority	2	3	2
	Direct loan subsidy outlays:			
1340	Micro loans	2	2	1
1340	Subsidy outlays-reestimates		1	
1349	Total subsidy outlays	2	3	1
	Guaranteed loan levels supportable by subsidy budget authority:			
2150	Microloan guarantees	1	2	2
2150	General business—7(a)	9,680	9,804	10,700
2150	General business—7(a) DELTA	16	20	20
2150	Section 504	1,809	3,750	3,750
2150	Section 504 DELTA		2	3
2150	SBIC debentures	385	500	600
2150	SBIC participating securities	1,261	1,957	2,500
2150	New Market Venture Capital		152	
2159	Total loan guarantee levels	13,152	16,187	17,575
	Guaranteed loan subsidy (in percent):			
2320	Microloan guarantees	8.32	7.95	8.17
2320	General business—7(a)	1.16	1.17	1.07
2320	General business—7(a) DELTA	1.83	1.88	0.56
2320	Section 504 program	0.00	0.00	0.00
2320	Section 504 DELTA	1.13	0.89	0.84
2320	SBIC debentures	0.00	0.00	0.00
2320	SBIC Participating Securities	1.80	1.31	1.87
2320	New Markets Venture Capital	15.00	14.44	14.47
2320	Y2k	4.07	4.04	0.00
2329	Weighted average subsidy rate	1.20	1.08	0.00
	Guaranteed loan subsidy budget authority:			
2330	General business—7(a)	112	115	
2330	SBIC participating securities	24	26	
2330	New Markets Ventue Capital	6	22	
2330	SBIC Debentures- upward reestimate		34	
2330	Section 504 — upward reestimate	5		
2330	7(a) downward reestimate	–284	–117	
2330	Section 504 downward reestimate		–180	
2330	SBIC Debentures downward reestimate		–91	
2330	SBIC Participating Securities Downward reestimate		–334	
2339	Total subsidy budget authority	–137	–525	
	Guaranteed loan subsidy outlays:			
2340	Microloan guarantees	1		
2340	General business—7(a)	113	110	
2340	General business—7(a) DELTA	2		
2340	SBIC participating securities	24	22	
2340	New Market Venture Capital	6	12	
2340	Y2K	1		
2340	Section 504 upward reestimate	5		
2340	SBIC debentures upward reestimate		34	
2340	7(a) downward reestimate	–284	–117	
2340	Section 504 downward reestimate		–180	
2340	SBIC debentures downward reestimate		–91	
2340	SBIC participating securities downward reestimate		–334	
2349	Total subsidy outlays	–132	–544	
	Administrative expense data:			
3510	Budget authority	129	129	129
3590	Outlays from new authority	129	125	129

As required by the Federal Credit Reform Act of 1990, as amended, this account records, for this program, the subsidy costs associated with the direct loans obligated and loan guarantees committed in 1992 and beyond (including modifications of direct loans or loan guarantees that resulted from obligations or commitments in any year), as well as administrative expenses of this program. The subsidy amounts are estimated on a present value basis; the administrative expenses are estimated on a cash basis.

For 2002, the budget proposes $130.5 million in new budget authority for the Business Loans Program account. This amount will be used to administer the loan programs and support $20.5 million in loans through the Microloan Direct program. For all other loan programs, we are proposing legislation to increase borrowing fees sufficient to cover subsidy obligations.

The Section 7(a) program provides general business credit assistance. The requested program level for 2002 is $10.7 billion. The Section 504 CDC Program is for long-term fixed rate financing and will require a program level of $3.75 billion in 2002. The Small Business Investment Companies (SBIC) program provides debt and equity capital. The budget proposes a program level of $2.5 billion for SBIC Participating Securities and $600 million for SBIC Debentures. The Microloan Direct program provides loans of $35,000 or less through intermediaries.

Object Classification (in millions of dollars)

Identification code 73–1154–0–1–376		2000 actual	2001 est.	2002 est.
25.2	Other services	129	130	129
41.0	Grants, subsidies, and contributions	198	216	2
99.9	Total new obligations	327	346	131

BUSINESS LOANS PROGRAM ACCOUNT

(Legislative proposal, not subject to PAYGO)

Summary of Loan Levels, Subsidy Budget Authority and Outlays by Program (in millions of dollars)

Identification code 73–1154–2–1–376		2000 actual	2001 est.	2002 est.
2320	General business—7(a)			–1.07
2320	SBIC participating securities			–1.87
2329	Weighted average subsidy rate			0.00

The Administration proposes to make the 7(a) General Business Loan and Small Business Investment Companies Participating Securities programs self-financing through fee increases, saving $141 million in government subsidies. The Administration's fee proposal acknowledges that some small businesses may have trouble accessing capital but does not require the government to subsidize their cost of borrowing.

Credit accounts—Continued

Business Guaranteed Loan Financing Account—Continued

Program and Financing (in millions of dollars)—Continued

Identification code 73–4149–0–3–376	2000 actual	2001 est.	2002 est.
68.90 Spending authority from offsetting collections (total discretionary)	1,119	1,018	1,126
Change in unpaid obligations:			
Unpaid obligations, start of year:			
72.40 Unpaid obligations, start of year	−87	176	777
72.95 Uncollected customer payments from program account, start of year	−118	−116	−55
72.99 Obligated balance, start of year	−205	60	722
73.10 Total new obligations	1,300	1,776	1,075
73.20 Total financing disbursements (gross)	−1,037	−1,175	−1,472
74.00 Change in uncollected customer payments from Federal sources	2	61	
Unpaid obligations, end of year:			
74.40 Unpaid obligations, end of year	176	777	380
74.95 Uncollected customer payments from program account, end of year	−116	−55	−55
74.99 Obligated balance, end of year	60	722	325
87.00 Total financing disbursements (gross)	1,037	1.175	1.472
Offsets:			
Against gross financing authority and financing disbursements:			
Offsetting collections (cash) from:			
Federal sources:			
88.00 Payments from program account	−151	−178	
88.00 Upward restimate	−3	−31	
88.00 Interest on reestimate	−2	−3	
88.25 Interest on uninvested funds	−22	−45	−46
Non-Federal sources:			
88.40 Fees	−435	−588	−800
88.40 Proceeds from loan asset sales	−60	−80	−124
88.40 other	−448	−154	−156
88.90 Total, offsetting collections (cash)	−1,121	−1,079	−1,126
Against gross financing authority only:			
88.95 Change in receivables from program accounts	2	61	
Net financing authority and financing disbursements:			
89.00 Financing authority			
90.00 Financing disbursements	−84	96	346

Status of Guaranteed Loans (in millions of dollars)

Identification code 73–4149–0–3–376	2000 actual	2001 est.	2002 est.
Position with respect to appropriations act limitation on commitments:			
2111 Limitation on guaranteed loans made by private lenders	14,874	16,187	17,575
2112 Uncommitted loan guarantee limitation	−3,006		
2131 Guaranteed loan commitments exempt from limitation	1,284		
2150 Total guaranteed loan commitments	13,152	16.187	17,575
Cumulative balance of guaranteed loans outstanding:			
2210 Outstanding, start of year	36,767	31,739	27,572
2231 Disbursements of new guaranteed loans	12,149	10,488	9,111
2251 Repayments and prepayments	−16,463	−13,965	−5,338
Adjustments:			
2261 Terminations for default that result in loans receivable	−681	−656	−670
2264 Other adjustments, net	−33	−34	−35
2290 Outstanding, end of year	31,739	27,572	30,640
Memorandum:			
2299 Guaranteed amount of guaranteed loans outstanding, end of year	23,280	20.679	22,459
Addendum:			
Cumulative balance of defaulted guaranteed loans that result in loans receivable:			
2310 Outstanding, start of year	753	817	1.011
2331 Disbursements for guaranteed loan claims	681	656	670
2351 Repayments of loans receivable	−204	−210	−214
2361 Write-offs of loans receivable	−236	−118	−61
2364 Other adjustments, net	−177	−134	−137
2390 Outstanding, end of year	817	1,011	1,269

As required by the Federal Credit Reform Act of 1990, as amended, this non-budgetary account records all cash flows to and from the Government resulting from loan guarantees committed in 1992 and beyond (including modifications of loan guarantees that resulted from commitments in any year). The amounts in this account are a means of financing and are not included in the budget totals.

Balance Sheet (in millions of dollars)

Identification code 73–4149–0–3–376	1999 actual	2000 actual	2001 est.	2002 est.
ASSETS:				
Federal assets:				
1101 Fund balances with Treasury	822	906	924	943
Investments in US securities:				
1106 Receivables, net	66	120	179	183
1207 Non-Federal assets: Advances and prepayments		449	245	250
Net value of assets related to post-1991 acquired defaulted guaranteed loans receivable:				
1501 Defaulted guaranteed loans receivable, gross	834	817	1,011	1,269
1502 Interest receivable	38	37	41	42
1505 Allowance for subsidy cost (−)	−215	−78	−88	−90
1599 Net present value of assets related to defaulted guaranteed loans	657	776	964	1,221
1901 Other Federal assets: Other assets	128	197	238	243
1999 Total assets	1,673	2,448	2,550	2,840
LIABILITIES:				
2204 Non-Federal liabilities: Liabilities for loan guarantees	1,786	2,448	2,550	2,840
2999 Total liabilities	1,786	2,448	2,550	2,840
4999 Total liabilities and net position	1,786	2,448	2,550	2,840

Business Guaranteed Loan Financing Account
(Legislative proposal, not subject to PAYGO)

Program and Financing (in millions of dollars)

Identification code 73–4149–2–3–376	2000 actual	2001 est.	2002 est.
Budgetary resources available for obligation:			
22.00 New financing authority (gross)			55
23.90 Total budgetary resources available for obligation			55
24.40 Unobligated balance carried forward, end of year			55
New financing authority (gross), detail:			
Spending authority from offsetting collections:			
Discretionary:			
Offsetting collections (cash):			
68.00 Offsetting collections (cash) 7(a) loan program			47
68.00 Offsetting collections (cash) SBIC Participating Securities program			8
68.90 Spending authority from offsetting collections (total discretionary)			55
Change in unpaid obligations:			
73.20 Total financing disbursements (gross)			−55
Unpaid obligations, end of year:			
74.40 Unpaid obligations, end of year			−55
74.99 Obligated balance, end of year			−55
87.00 Total financing disbursements (gross)			55
Offsets:			
Against gross financing authority and financing disbursements:			
Offsetting collections (cash) from:			
Non-Federal sources:			
88.40 Fees from 7(a) loan program			−47

7a Reestimate Amount *(Dollars in Thousands)*
Includes principal only and Technical Re-estimates

Reestimate Summary
DRAFT

	1997 Budget	1998 Budget	1999 Budget	2000 Budget	2001 Budget	2002 Budget	Cumulative Change
1992 Cohort	$ 4,099	$ (55,389)	$ (29,806)	$ (73,695)	$ (4,711)	$ (4,183)	$ (163,085)
1993 Cohort	$ (14,139)	$ (77,011)	$ (50,462)	$ (79,558)	$ (21,398)	$ (16,085)	$ (258,653)
1994 Cohort	$ 52,891	$ (13,610)	$ (62,959)	$ (60,366)	$ (11,505)	$ (4,376)	$ (99,925)
1995 Cohort	$ 10,347	$ 48,620	$ (68,391)	$ (59,816)	$ (774)	$ (3,619)	$ (73,453)
1996 Cohort		$ 32,401	$ 37,280	$ (101,090)	$ (15,994)	$ (9,349)	$ (56,752)
1997 Cohort			$ (23,636)	$ (86,258)	$ (38,550)	$ (333)	$ (148,777)
1998 Cohort				$ (52,221)	$ (38,744)	$ (39,467)	$ (130,432)
1999 Cohort					$ (13,018)	$ (11,392)	$ (24,410)
2000 Cohort						$ (2,526)	$ (2,526)
Total Change	$ 53,998	$ (64,989)	$ (198,174)	$ (513,024)	$ (144,694)	$ (91,130)	$ (958,013)

Total Re-estimate Amount *(Dollars in Thousands)*

Prin. Only Re-Estimate	$ 53,998	$ (64,989)	$ (198,174)	$ (513,024)	$ (144,694)	$ (91,130)	$ (958,013)
Interest	$ 3,454	$ (35,092)	$ (74,093)	$ (122,319)	$ (27,213)	$ (24,492)	$ (279,755)
Interest on Re-estimate	$ 1,284	$ -	$ (4,618)	$ (11,467)	$ (3,032)	$ (1,902)	$ (19,735)
Total Re-estimate Amount	$ 58,737	$ (100,081)	$ (276,885)	$ (646,810)	$ (174,939)	$ (117,524)	$ (1,257,503)

default 13.87
recoveries 60.3

7a Subsidy Rate Reestimates

	Execution Rate	1997 Budget	1998 Budget	1999 Budget	2000 Budget	2001 Budget	2002 Budget
Cohort 1992 (Technical)	4.85%	4.94%	3.88%	3.31%	1.90%	1.81%	1.73%
(Interest)		5.38%	5.38%				
Cohort 1993 (Technical)	5.21%	4.97%	3.67%	2.82%	1.48%	1.12%	0.85%
(Interest)		5.43%	5.43%				
Cohort 1994 (Technical)	2.15%	2.91%	2.70%	1.82%	0.98%	0.82%	0.76%
(Interest)		2.19%	2.19%				
Cohort 1995 (Technical)	2.74%	2.97%	3.61%	2.61%	1.77%	1.76%	1.71%
(Interest)		2.95%	2.97%				
Cohort 1996 (Technical)	1.06%		2.40%	2.17%	0.58%	0.34%	0.20%
(Interest)			1.07%	1.06%			
Cohort 1997 (Technical)	1.93%			1.39%	0.44%	0.02%	0.03%
(Interest)						2.23%	
Cohort 1998 (Technical)	2.14%				1.00%	0.88%	0.41%
(Interest)						1.23%	
Cohort 1999 (Technical)	1.39%					1.03%	1.12%
(Interest)						1.37%	0.89%
Cohort 2000 (Technical)	1.16%						1.10%
(Interest)							

SBA FY 2000 7(a) and 504 Approval Volume by State
Dollars in Thousands

State	7(a) # of loans	7(a) $ Amount	504 # of Loans	504 $ Amount
Alaska	77	$ 14 327	7	$ 3.502
Alabama	356	$ 88.496	97	$ 33.207
Arkansas	378	$ 70.665	17	$ 5.211
Arizona	835	$ 267,699	122	$ 54.576
California	6224	$ 1.974.686	1031	$ 473.978
Colorado	819	$ 288.168	80	$ 33.982
Connecticut	1038	$ 168.763	23	$ 7.926
Delaware	97	$ 17,678	10	$ 1,992
Florida	1867	$ 580,858	208	$ 78,377
Georgia	1067	$ 386,205	105	$ 34.363
Hawaii	162	$ 24,706	15	$ 7.109
Idaho	360	$ 56.836	61	$ 16.740
Illinois	1132	$ 242,383	203	$ 89,065
Indiana	581	$ 135,831	99	$ 31,104
Iowa	449	$ 60,655	85	$ 24.839
Kansas	413	$ 75,255	51	$ 14,991
Kentucky	386	$ 75,464	28	$ 11.042
Louisiana	495	$ 109,461	36	$ 12.382
Maine	423	$ 42,542	23	$ 5,786
Maryland	619	$ 135,644	55	$ 19,538
Massachusetts	1115	$ 183,546	104	$ 43.418
Michigan	939	$ 284,814	67	$ 34,994
Minnesota	1143	$ 234,779	176	$ 63,072
Mississippi	361	$ 77,529	26	$ 13,061
Missouri	760	$ 133,805	95	$ 31,518
Montana	343	$ 55,505	11	$ 3,159
Nebraska	287	$ 44,035	17	$ 7.323
Nevada	357	$ 101,686	72	$ 29,552
New Hampshire	528	$ 48,524	124	$ 31,070
New Jersey	1697	$ 391,843	32	$ 18,635
New Mexico	277	$ 54,596	28	$ 10,461
New York	3444	$ 531,144	202	$ 68,157
North Carolina	537	$ 131,983	107	$ 41,736
North Dakota	234	$ 35,576	32	$ 9,769
Ohio	1459	$ 305,555	144	$ 48,590
Oklahoma	491	$ 115,587	24	$ 7,952
Oregon	491	$ 129,795	47	$ 23,121
Pennsylvania	1740	$ 321,304	63	$ 27,617
Rhode Island	735	$ 89,217	15	$ 5,635
South Carolina	290	$ 76,717	30	$ 13,756
South Dakota	178	$ 26,292	13	$ 3,645
Tennessee	410	$ 103,973	45	$ 18,413
Texas	4036	$ 1,390,716	155	$ 70,879
Utah	618	$ 103,609	191	$ 63,563
Vermont	203	$ 31,710	6	$ 1,045
Virginia	590	$ 138,963	120	$ 47,030
Washington	916	$ 250,219	95	$ 46,365
West Virgina	181	$ 31,449	5	$ 2,945
Wisconsin	758	$ 146,761	117	$ 57,015
Wyoming	133	$ 25,232	13	$ 4,357
Dist. Of Columbia	65	$ 19,484	9	$ 3,449
Puerto Rico	598	$ 83,676	24	$ 8,618
Totals	43692	$ 10,515,946	4565	$ 1,819,630

NAGGL

The National Association of Government Guaranteed Lenders, Inc.

March 16, 2001

The Honorable Christopher Bond
Chairman, Senate Small Business Committee
274 Russell Senate Office Building
Washington, DC 20510-2503

The Honorable Donald Manzullo
Chair, House Small Business Committee
409 Cannon House Office Building
Washington, DC 20515-1316

Re: SBA 7(a) Loan Program

Dear Chairmen:

The Small Business Administration's (SBA) 7(a) loan program has proven to be an excellent public/private partnership. Since the program's inception, the SBA has made or guaranteed more than 600,000 loans totaling approximately $80 billion. There are many positive attributes of the 7(a) loan program, including:

- It has been estimated that SBA loan programs provide as much as 40% of all long-term loans (with over three year maturities) to small businesses.

- SBA 7(a) loans have significantly longer maturities than conventional small business loans. The average original maturity of SBA 7(a) loans, according to the Office of Management and Budget (OMB), is 14 years. By comparison, only 16% of conventional small business loans have maturities in excess of one year, and of those loans, the average maturity is less than 4 years.

- Longer loan maturities mean lower monthly payments for borrowers. For example, if a borrower were precluded from receiving an SBA guaranteed loan with a 10-year maturity because of Federal budget considerations, even if he or she were able to receive a conventional loan with a 5-year maturity (which is highly unlikely), the monthly payments would increase 36 percent—a huge blow to the health and profitability of a small business.

- Small businesses do not have the same access to capital as do large businesses. The SBA programs bridge that capital gap. Banks cannot be expected to make long-term loans, the kind most needed by small businesses, with a short-term deposit base.

- The 7(a) appropriations are currently leveraged almost 99 to 1 by the private sector, making this one of the government's best economic development instruments.

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- The SBA 7(a) loan program is just that—a loan program—which helps qualified small businesses obtain the capital they need for growth and expansion. This means jobs and a "net return on investment" for our local communities and the U.S. Treasury.

The members of NAGGL ask for your support for the SBA 7(a) loan program. Due to federal regulators pushing for tighter bank underwriting requirements in FY 2002, we estimate that small business loan demand for the 7(a) program will be $11 billion, up 10% from FY 2001. At the estimated 1.07% subsidy rate, this means Congress would need to appropriate $117.7 million. This sum would represent an 8.75% decrease in appropriations from FY 2001 due to a reduction in the subsidy rate.

Our request runs counter to the President's budget outline for the SBA 7(a) program in FY 2002. That budget proposal provides for no appropriations, and calls for an increase in the already excessive program fees. We find the proposal unacceptable for several reasons, including:

- SBA Administrator Aida Alvarez testified before Congress in 2000 that the SBA 7(a) program was already "being run at a profit to the government."

- OMB continues to use a default estimate in the model used to calculate the 7(a) subsidy rate that is far in excess of actual and anticipated default rates. In 2000, SBA officials testified that the estimated default rates were "in the 8-10% range," yet OMB is still using an approximate 14% estimate. Using an anticipated default rate of just 10% would reduce the subsidy rate for the SBA 7(a) program to nearly zero.

- Rather than eliminating 7(a) appropriations, thus imposing more fee increases, Congress should look at the subsidy calculation being made by OMB and determine why such excessive cost estimates are being used. In the meantime, Congress should support $117.7 million in appropriations for FY 2002. This would support an $11 billion SBA 7(a) program at the OMB-determined subsidy rate of 1.07%.

- A survey of the NAGGL membership indicates that 75 percent of 7(a) lenders would significantly reduce their SBA 7(a) loan volume if the President's proposal were adopted. Respondents indicated, on the one hand, that a further increase in borrower fees would be prohibitive for many small businesses, and on the other, that bank profitability in making SBA guaranteed loans would decline substantially if lender fees were increased again.

We urge you to make sure there remains a viable, usable SBA 7(a) loan program by rejecting any further program fee increases, and supporting sufficient appropriations ($117.7 million) to support an $11 billion SBA 7(a) loan program for FY 2002.

Respectfully,

Anthony R. Wilkinson

Anthony R. Wilkinson
President & CEO

NASBIC
America's Small Business Partners

Statement
of
Lee W. Mercer
President

National Association of
Small Business Investment Companies

Before The

United States House of Representatives
Committee on Small Business

May 16, 2001

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Chairman Manzullo, Representative Velázquez, members of the Committee:

On behalf of the National Association of Small Business Investment Companies, I appreciate the opportunity to testify today concerning the Administration's FY 2002 SBIC program budget proposal. As indicated by the attached compilation of FY 2000 statistics, the SBIC program continues to be one of the most successful of the government's small business finance programs.

The budget proposal calls for an increase in Participation Security SBIC fees to bring the estimated subsidy rate for that program to zero, rendering unnecessary any appropriations to cover possible losses by the government with respect to guaranteed leverage used to augment SBIC private capital. The increase would apply to Participating Security SBICs only. Fees paid by Debenture SBICs are already sufficient to render the subsidy rate zero in that program.

The increase proposed by the budget is 37.6 basis points per year on outstanding FY'02 leverage. Imposition would require legislation raising the 1.0% per year maximum permitted prioritized payment rate paid directly to the Government (§303(g)(2) of the Small Business Investment Act) to at least a maximum of 1.376%. With certain reservations, NASBIC supports the fee increase.

At first reading, the increase seems substantial. However, the fee to be increased is but one of several fees paid by Participating Security SBICs for the government-guaranteed leverage that makes the program attractive to private sector investment professionals and investors who are the foundation of the SBIC program. In context, the proposed increase is not substantial.

The total annual rate that SBICs pay for leverage is made up of three major components:

1. The amortized values of one-time leverage charges. These are a 1.0% leverage commitment fee, a 2.0% leverage draw fee, and a 0.5% underwriting fee (for the sale of government-guaranteed securities that generate the funds for leverage). The total of 3.5% is amortized over 7 years, the period that leverage is generally estimated to be outstanding. Discounting cost-of-money considerations, the rate equals 0.5% per year.
2. An annual percentage rate set by the public markets when the government-guaranteed securities are sold. The February 2001 Participating Security pool rate was 6.64%.
3. An annual percentage rate on outstanding leverage paid directly to the U.S. Government. The rate is set by the Small Business Investment Act. The current rate is 1.0% per year. The President's proposal would change that rate to 1.376% for FY 2002 leverage.

Thus, the total annual rate paid by Participating Security SBICs for leverage is currently:

$$0.5\% + 6.64\% + 1.00\% = 8.14\%$$

Under the President's proposal the calculation would be as follows:

$$0.5\% + 6.64\% + 1.376\% = 8.516\%$$

Although no one enjoys fee increases, the proposed increase would not adversely affect either Participating Security SBICs or small businesses to which they provide equity financing. In fact, in FY 2000, the SBIC program's most successful year to date, the total annual rate paid by Participating Security licensees rose to 9.517% for the $455 million in leverage financed in February 2000. The proposal is not unreasonable and, if implemented correctly, should dramatically increase the amount of equity capital that will be available for small businesses.

Increasing the amount of FY 2002 leverage available to Participating Security SBICs is critical to the SBIC program and small businesses relying on SBICs for equity financing. The table below provides projected Participating Security leverage requirements through FY 2002 for existing Participating Security SBICs and those funds that we estimate will receive Participating Security licenses over the next twelve months. The estimate, $3.5 billion, is conservative: it includes only 50% of the prospective Participating Security SBICs that have already had their Management Assessment Questionnaires approved by SBA. Further, the projected number of new licensees is only 80% of the average number of Participating Security SBICs licensed per year by SBA in FY 2000 and FY 2001. The estimates are based on the standard SBIC model of one part private capital and two parts government guaranteed capital.

	Number of PS SBICs	Private Capital (x)	Current Leverage/ Commitments (y)	New Leverage Required (2x-y)
Current PS SBICs:	145	$3.3 billion	$4.5 billion	$2.1 billion
Est. New PS SBICs:	25	$ .7 billion	$0.0 billion	$1.4 billion
Totals:	170	$4.0 billion	$4.5 billion	$3.5 billion

As stated, the estimate of required Participating Security leverage availability is conservative. Participating Security SBICs have used virtually all leverage made available to them over the past few years and commitments for new leverage are now being rationed to some degree by SBA. Failure to make the total of $3.5 billion available would have a negative impact on the program. Private investors and private management teams, the foundation of the SBIC program, would necessarily begin to question whether the government was pulling back from its commitment to the growth of the program. At a time when individual private investors, the foundation of the SBIC program, are reducing their investments in venture capital funds overall, growth in the SBIC program will be particularly important to U.S. small businesses. The House Small Business Committee has been a primary leader with respect to SBIC program growth over the past five years and we hope the Committee will continue that leadership by ensuring that $3.5 billion in Participating Security leverage is available in FY 2002.

Given current budgetary constraints, we believe that it would be almost impossible for Congress to make the required leverage available without fee increases. At best we might hope for level funding in the SBIC program. The FY 2001 subsidy appropriation was $26.2 million. Due to variables in OMB's subsidy model that can produce increases in subsidy rate projections when the Federal funds rate is falling, such as at present, the FY 2002 Participating Security subsidy rate will increase from 1.31% to 1.87 percent. It is an increase unrelated to any projected negative management performance, but an increase nonetheless. Applying the new rate to an appropriation of $26.2 million would make only $1.4 billion in Participating Security leverage available without an increase in fees. The full $3.5 billion would require $65 million in appropriations—a 148% increase. Thus, we see increased fees as a necessity to secure the growth we believe is required for the Participating Security SBIC program. We hope to work with your committee to secure legislation that is required to achieve this result.

NASBIC Concerns With Respect To The Budget Proposal

As we have said, our support of the President's budget proposal is conditional. One of our concerns, related directly to amounts available for appropriations, is the number of personnel and other resources available to SBA for running the Investment Division, the unit responsible for managing the SBIC program. In fact, we believe that the greatest danger to the SBIC program at present is not the increase in fees proposed for Participating Security SBICs, but lack of adequate personnel and required expense resources for the Investment Division. It may seem strange to some that a regulated industry would ask for more regulators, but that is the case. Lack of adequate personnel has a direct impact on the ability of SBA to process SBIC license applications and on SBA's ability to conduct necessary SBIC compliance examinations on a regular basis. Expeditious processing of license applications and regular examinations, certainly of leveraged SBICs, are necessary to the continued health and success of the program.

Since the close of FY 1993, the number of SBICs has increased from 280 to 411, an increase of 47%. The amount of outstanding and committed government-guaranteed leverage has increased from $860 million to $6.4 billion, an increase of 644%. During this same period, the Investment Division's staff has actually dropped from 93 to 90, a 3% drop. The total budget for the division has increased from $6.2 million to approximately $7.7 million, but the increase averages just over 3% per year—hardly sufficient to keep pace with the growth of the program. The Investment Division has shown considerable ability during this period to meet the substantial increases in its workload and responsibility by increasing productivity. However, it is NASBIC's feeling that the limits of what may be accomplished through productivity increases may have been reached. We urge both this Committee and the Administration to address what we see as a requirement for more resources in the Investment Division. Although not directly related, we hope that our agreement to support the President's budget, whether eventually adopted in whole or in part, will have a positive impact on resources that will be made available to the Investment Division.

Our second concern is that the leverage available to SBICs in FY 2002 be the maximum authorized by the Small Business Investment Act. As amended by Congress last year, the authorized program levels for FY 2002 are $2.5 billion for Debentures and $3.5 billion for Participating Securities. The Administration's budget proposal speaks in terms of lesser amounts. We believe that the conflict relates more to a misunderstanding as to the normal course when subsidy rates fall to zero than to an intention to amend through the appropriations process the authorization levels set by the Small Business Committees and approved by Congress last year. With the Debenture subsidy rate already at zero and the Participating Security rate moving to zero, we ask the Committee to ensure that no artificial limits be put on the previously approved authorization levels through the appropriations process.

We believe the Committee should address one additional issue concerning fees and subsidy rates. We understand that OMB, in connection with its preparation of the FY 2002 budget, has re-estimated the reserves required to meet estimated losses associated with the Debenture program from FY 1992 through FY 2000 and the Participating Security program from its inception in FY 1994 through FY 2000. The foundation of those reserves is made up of the fees paid by SBICs and the subsidy appropriations made by Congress for those years. We understand that as a result of the re-estimate that OMB has determined that the reserve accounts had a cumulative total of approximately $390 million more than required to meet anticipated losses. Apparently, that amount has been "released" to the Treasury for general funding of the government. If correct, SBICs and taxpayers were overcharged by $390 million over the past nine years. During that period, Congress appropriated approximately $257 million to cover all SBIC subsidy reserves, including those of the SSBIC program. The re-estimate indicates not only that those appropriations were unnecessary, but that approximately $133 million of the fees paid by SBICs may have been unnecessary to protect the Government's interests.

We appreciate the fact that estimating possible SBIC program losses is an inexact science, but the magnitude of the "over-estimation" appears to be so large as to raise serious questions in our minds as to the basis for current subsidy rates, particularly that for the Participating Security program. Of the $390 million, we understand $334 million is attributable to the Participating Security program. Now that we have learned of the over-estimation in prior years, we question how the Participating Security subsidy rate can jump from 1.31% to 1.87%, a 43% increase, in the same year that the re-estimation has occurred. Our concern is further supported by the fact that OMB made a substantial error in calculating the Debenture subsidy rate in its initial FY 2001 budget submission. It was only after NASBIC raised the issue that OMB corrected its mistake.

Thus, while we have said that we can support an increase in Participating Security program fees to achieve the program growth we believe is necessary, we ask that the Committee question the Administration closely concerning the increase in the subsidy rate that makes most of the fee increase necessary. In this regard, we support the request made by the Chairmen and Ranking Minority Members of both the House and Senate Small Business Committees for a General Accounting Office report on subsidy rates in SBA's 7(a) program. We believe that report may have some applicability to the SBIC program as well.

Suggested SBIC Legislation

- **Paperwork Reduction In Potential Conflict Of Interest Situations**

In anticipation of the requirement for legislation that would increase fees paid by Participating Security SBICs, legislation we hope this committee will support, we ask you to consider two additional legislative proposals that will improve the SBIC program. First, we suggest that Section 312 of the Small Business Investment Act, dealing with potential conflicts of interest be amended to eliminate the requirement that notice of potential conflicts of interest include, in addition to other requirements imposed by SBA, "disclosure in the locality most directly affected by the transaction."

SBA maintains primary jurisdiction over transactions with potential conflicts of interest and may refuse to grant a waiver for any transaction to go forward if SBA believes the potential conflict has not been addressed satisfactorily. SBA publishes notices of potential conflicts of interest in the Federal Register so that the public has notice of any potential conflicts and the opportunity to respond. However, the locality disclosure clause in the Act requires also that notice of a potential conflict must also be published in a paper in the appropriate jurisdiction, with a copy mailed to SBA. To the best of our knowledge, no individual has ever contacted SBA as a result of such a publication in a "local" paper. The result has been a duplicative process that imposes a cost, in terms of both time and money, on both SBA from a regulatory standpoint and SBICs and small businesses from an investment transaction standpoint.

We believe the "locality publication" requirement of the statute is unnecessary. Without the locality clause Section 312 would read as follows:

> "For the purpose of controlling conflicts of interest which may be detrimental to small business concerns, to small business investment companies, to the shareholders, partners, or members of either, or to the purposes of this Act, the Administration shall adopt regulations to govern transactions with any officer, director, shareholder, partner, or member of any small business investment company, or with any person or concern, in which any interest, direct or indirect, financial or otherwise, is held by any officer, director, shareholder, partner, or member of (1) any small business investment company, or (2) any person or concern with an interest, direct or indirect, financial or otherwise, in any small business investment company. Such regulations shall include appropriate requirements for public disclosure necessary to the purposes of this section."

The amended statute would still give SBA all the authority required to address potential conflict of interest situations without requiring any publication that SBA may deem unnecessary. We believe that SBA supports this proposed amendment.

- **UBTI Exemption For Tax-Exempt Organizations Investing In SBICs**

The second legislative proposal we ask the Committee to consider and support is an amendment to Section 512(b) of the Internal Revenue Code that would exempt income received by tax-exempt institutional investors from SBICs they have invested in from treatment as Unrelated Business Taxable Income (UBTI). UBTI is subject to filing requirements and taxation. The exemption would provide Debenture SBICs with access to substantial sources of potential private capital that are not available to them at present, capital sources that are available to Participating Security SBICs and other equity based venture capital funds. The amendment we suggest would add the following as Internal Revenue Code §512(b)(18):

> "(18) Special rule for investment in Small Business Investment Companies. There shall be excluded all income attributable to an investment in a small business investment company operating under the provisions of the Small Business Investment Act of 1958. This paragraph shall apply to a small business investment company formed as a limited liability company, a partnership, or a corporation."

Without the exemption, UBTI rules make it virtually impossible for Debenture SBICs to raise private capital from tax-exempt institutional investors. The reason is not that tax-exempt institutional investors do not invest in venture capital funds. Indeed, according to Thomson Financial / Venture Economics of Newark, New Jersey, these institutional investors provide approximately 60% of the capital invested in venture capital funds each year. However, the vagaries of the tax law are such that virtually all of this money is invested in equity oriented venture capital funds, funds that do not raise any of their capital by way of borrowing and that do not structure their investments as loans as opposed to stock purchases. Investments in equity-oriented funds do not create UBTI for tax-exempt investors.

The following are examples of how UBTI rules can have a negative impact on Debenture SBIC fundraising. The first is a statement by Keith R. Fox, founder and managing partner of Exeter Venture Partners.

> "The first Exeter fund was a non-SBIC and did not generate any UBTI. It attracted several pension funds and foundations. Our next fund was a Debenture SBIC, which generated UBTI. All the tax-exempt investors dropped out. Our third fund was a Participating Security SBIC, which did not generate UBTI. It had two tax-exempt investors representing 20% of the capital. Our fourth fund was a Debenture / Participating Security hybrid fund, which generated UBTI. All the tax-exempt investors dropped out. Although there may have been other reasons, UBTI was a major determining factor."

A more recent example is that of InvestAmerica Investment Advisors of Cedar Rapids, Iowa. David Schroder, President of InvestAmerica is trying to raise capital for a new Debenture SBIC and has hit a substantial UBTI roadblock. He has written me as follows:

> "A month ago I was explaining to various congressional members that UBTI could potentially reduce funding for our fund raising. I am now facing an actual funding reduction that could prove disastrous for our new fund.
>
> "A state pension fund is balking at the prospect of UBTI and may not invest. This may reduce our fund raising by 50% and result in a reduction of our investment capacity by approximately $22,500,000. This will be a significant reduction of the capital that we will be able to invest in rural states that already are faced with a need for our type of capital.
>
> "The need to exempt tax-exempt funds from UBTI when investing in Debenture SBICs has become painfully real to us. Please help us secure this exemption which will in turn help to create more capital for SBICs."

These results make no sense in the context of the government's SBIC Debenture program. As with Participating Security funds, in return for agreeing to invest only in U.S. small businesses that meet small business size standards, Debenture SBICs can augment their private capital with government-guaranteed capital. For Debenture SBICs that government-guaranteed capital comes in the form of a loan, the proceeds of which must be used primarily for loans to the small businesses SBICs finance. The program was designed to enable Debenture SBICs to make loans to small businesses that are generally subordinate to, and may be the basis for, more senior credit facilities from commercial banks. As such, these subordinated loans are often critical to the survival of the small businesses that secure them. Such loans are particularly suited for family-owned businesses that may never reach the growth required to "go public," or, for companies whose owners may never want to lose equity in or control of their companies by the sale of large blocks of stock. These companies are often found in the heartland of America, not the "hot" locations that typically attract media attention. Nonetheless, these companies are important to America's economic wellbeing in general and the health of their local communities in particular. They are often primary employers in the areas in which they are located.

UBTI tax rules that serve as roadblocks for Debenture SBIC managers trying to provide the above loans have no place in the context of the SBIC program. The express congressional policy of the Small Business Investment Act is: "to improve and stimulate the national economy in general and the small business segment thereof in particular by establishing a program to stimulate and supplement the flow of private equity capital and long-term loans which small-business concerns need for the sound financing of their business operations and for their growth, expansion, and modernization ... provided, however, that this policy shall be carried out in such a manner as to insure the maximum participation of private financing sources." Section 102 of the Act, emphasis added. Private capital held by tax-exempt organizations represents the large majority of private capital potentially available to SBICs for investing in domestic small businesses. To advance the express policy of the Small Business Investment Act, it is reasonable that Congress exclude from the definition of UBTI any income received by a tax-exempt organization that is derived from an investment in an SBIC.

There should be no revenue loss to the government if an exemption from UBTI consequences is provided for tax-exempt institutional investors investing in SBICs. Tax-exempt investors allocate only a finite percentage of their capital to the class of investments represented by venture capital funds. The government is receiving little if any tax revenue attributable to Debenture SBIC UBTI at present since tax-exempt investors invest their allocated amounts in equity-oriented funds that do not produce UBTI. Allowing Debenture SBICs to compete for such funds on even terms with other venture capital funds would not cause tax-exempt investors to increase the amount of capital allocated to that class of investments. The change would simply remove the UBTI roadblock that prevents tax-exempt institutional investors from allocating a small but important portion of their venture funds to Debenture SBICs that the government has already deemed worthy of support.

Notwithstanding our belief that there would be no revenue loss to the government, we understand that the Joint Committee on Taxation did estimate revenue loss in connection with a 1992-1993 attempt to secure the same exemption. The loss was estimated to be $12 million over five years. The amount was inconsequential then, as it would be now, when compared to the benefits that would accrue as Debenture SBICs increased the amount of capital available to U.S. small businesses for difficult to obtain loans. Debt financing is as important in the development of growing small businesses as is equity financing. A minimal loss should not be a hurdle that would prevent Congress from supporting a well-justified amendment to the tax code. We hope upon consideration, the Committee will support our proposed amendment and work with the Ways and Means Committee to provide the exemption we have suggested.

Thank you again for your consideration our views. We look forward to working with you again this year to further improve the SBIC program and its ability to help America's small businesses.

NASBIC
America's Small Business Partners

Small Business Investment Company Program Statistics
Fiscal Year 2000 SBIC Data Provided By SBA

Investments By Type Of SBIC	Number	Total $ Amount	$ %	$ Average	$ Median
Participating Security SBICs	1,613	1,458,043,528	27%	903,933	500,000
Debenture SBICs	1,994	862,546,615	16%	432,571	150,000
Bank SBICs (No Leverage)	739	3,082,858,957	56%	4,171,663	1,462,802
Specialized SBICs	293	62,830,564	1%	214,439	175,000
Total Investments	**4,639**	**5,466,279,664**	**100%**	**1,178,331**	**250,000**
Category Of Investments					
Straight Debt	1,713	392,697,531	7%	229,245	100,000
Debt With Equity Features	960	1,052,258,835	19%	1,096,103	357,609
Equity Only	1,966	4,021,323,298	74%	2,045,434	750,000
Total Investments	**4,639**	**5,466,279,664**	**100%**	**1,178,331**	**250,000**
Investments By Business Age					
Under 3 Years	2,641	3,427,424,798	63%	1,297,775	250,000
3 to 6 Years	932	963,171,136	18%	1,033,445	225,590
6 to 10 Years	489	393,911,316	7%	805,545	188,000
Over 10 Years	577	681,772,414	12%	1,181,581	300,000
Total Investments	**4,639**	**5,466,279,664**	**100%**	**1,178,331**	**250,000**
Investments By Business Type					
Technology Businesses	1,468	1,967,860,679	36%	1,340,505	500,000
Non-Technology Businesses	3,171	3,498,418,985	64%	1,103,254	200,000
Total Investments	**4,639**	**5,466,279,664**	**100%**	**1,178,331**	**250,000**
Investments In LMI Areas					
Low-Income Areas	705	743,230,215	14%	1,054,227	140,000
Moderate-Income Areas	613	608,529,152	11%	992,707	203,750
Total LMI Investments	**1,318**	**1,351,759,367**	**25%**	**1,025,614**	**193,181**

Notes:
1. A total of 3,060 small businesses received SBIC financing from 4,639 investments made in FY 2000.
2. SBIC investments were about 48% of all VC transactions and 12% of all VC dollars for the period.
3. The average non-SBIC venture capital investment equaled approximately $11 million in 2000.
4. Approximately 85% of all non-SBIC venture capital investments are made in high-technology firms.
5. Participating Security SBICs had distributed $264 million in profits to SBA through April 25, 2001.

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Lee W. Mercer

Lee Mercer is president of the National Association of Small Business Investment Companies (NASBIC), having joined the association in that capacity in 1996. NASBIC represents the interests of the SBIC industry in Washington, DC and provides other professional, educational, and meeting services for industry members. SBICs are government-licensed, government-regulated, but privately managed venture capital firms that form the core of a government-industry partnership established to stimulate U.S. job creation and economic development by way of privately managed investments in growing small companies. SBICs now manage over $17 billion in venture capital resources. Since creation of the program in 1958, SBICs have invested more than $27 billion in over 88,000 small U.S. businesses, with nearly $5.5 billion invested in FY 2000. Many successful public companies received early venture capital financing from SBICs—including Intel, Sun Microsystems, Federal Express, Callaway Golf, Staples, Mothers Work, and Outback Steakhouse. These and the stories of many other successful SBIC portfolio companies may be found on NASBIC's Internet site at www.nasbic.org.

Prior to joining NASBIC, Lee had worked in both the private and public sectors. He was a partner in the largest New Hampshire law firm, a senior government program manager and lobbyist for Digital Equipment Corporation, and the president of two privately owned small businesses. In government, Lee served as legislative director and counsel for former U.S. Senator Warren Rudman (R-NH) and as a deputy undersecretary of commerce at the U.S. Department of Commerce during parts of both the Reagan and Bush Administrations. While with Senator Rudman, Lee was the primary manager of the legislation that created the Small Business Innovative Research (SBIR) program, a program that provides more than $1.2 billion per year in federal R&D contracts to small, technology-based companies. During his career, Lee has served as a director of several private companies and as a member of several high-level government advisory boards.

Lee received his BA degree from Dartmouth College and JD and LLM degrees from Boston University School of Law. He served in the U.S. Marine Corps from 1966 to 1968. Lee has three sons and lives in Arlington, Virginia with his wife Deborah.

STATEMENT

by

The National Association of Development Companies

on

The Small Business Administration

504 Loan Guaranty Program
Proposed FY 2002 SBA Budget

Submitted to the

COMMITTEE ON SMALL BUSINESS

UNITED STATES

HOUSE OF REPRESENTATIVES

by

Ms. Zola Finch

NADCO Vice President for Congressional Relations
&
Director of Finance Programs
Rural Missouri, Inc.
Jefferson City, Missouri

May 16, 2001

The National Association of Development Companies (NADCO) is pleased to provide a statement to the House of Representatives Committee on Small Business concerning the SBA budget proposed by the Administration for FY 2002. NADCO is the trade association for SBA 504 Certified Development Companies (CDCs). We represent 250 CDCs and more than 175 affiliate members, who together provided more than 95% of all SBA 504 financing to small businesses during 2000. NADCO's mission is to serve as the key advocate for the 504 program. As the Committee knows, 504's objective is economic development and specifically job creation. No other Federal program can claim to have created over 600,000 jobs, as the 504 program has done. This mission is more important today than ever before, with our economy stuck in neutral at best, and in recession at worst.

As background, I am the Director of Finance Programs and Assistant Secretary of Rural Missouri Inc. d/b/a Resources for Missouri, Inc. (RMI), with offices throughout the state and the headquarters are in the state capital, Jefferson City. RMI provides two types of services: U.S. Department of Labor Workforce Investment Act 167 Program which provides job training and education assistance to low-income farm workers who are seasonally employed or who desire to go to school and we offer five financing programs to small businesses in Missouri.

RMI became the statewide Certified Development Company in 1983 for the 503/504 Program. RMI has provided financing to 453 businesses totaling $133 million and created 8,500 jobs for Missouri. In addition to the SBA 504 Program , RMI offers the following economic development financing programs to Missouri small businesses: 1)SBA Microloan Program made possible through a loan to RMI from SBA that has financed 106 businesses totaling $1.8 million; 2)Intermediary Re-lending Program made possible through a loan to RMI from the U. S. Department of Agriculture—Rural Development that has financed 48 businesses totaling $5.1 million; 3)Rural Business Enterprise Loan program which originated through a grant to RMI from the U.S. Department of Agriculture—Rural Development that has financed five businesses totaling $175,000; 4)Small Business Investment Fund which originated through a grant from the U.S. Department of Health and Human Services that has financed 25 businesses totaling $600,000.

NADCO would like to thank Chairman Manzullo, Representative Velazquez, and the entire Committee, for continued support of the 504 program and the CDC industry. The Committee's passage of the 504 program reauthorization bill last year was another step toward improvement and expansion of the 504 program, to the benefit of all potential small business borrowers. Both Congressional Small Business Committees worked long and hard with the Congressional leadership and the Administration to complete a bill that expanded availability of capital to more small businesses, and streamlined our loan-making processes through the PCLP CDC program.

We have four objectives in providing this testimony to the Committee. First, NADCO would like to comment on the 504 authorization level and the proposed borrower fee contained in the FY 2002 budget for SBA.

Second, we will compare some of the portfolio performance projections by SBA and OMB with the *actual historical performance* to date for the 504 loan portfolio.

Third, we will comment on some of the SBA Performance Plan objectives submitted to Congress with the FY 2002 SBA budget.

Fourth, we will provide the Committee with several 504 program proposals that could result in additional improvements as we serve America's small businesses.

PROPOSED SBA FY 2002 BUDGET

1. 504 PROGRAM AUTHORIZATION LEVEL

SBA has proposed that the authorization level for the 504 program be set for FY 2002 at $3.75 billion. The Congress last year overwhelmingly passed 504 legislation providing for the following authorization levels:

- **FY 2001 $4.0 billion**
- **FY 2002 $4.5 billion**
- **FY 2003 $5.0 billion**

NADCO continues to support the authorization levels passed by Congress for three reasons. First, while long term interest rates may be falling today as the Federal Reserve combats this economic downturn, it is not clear that rates will continue to remain low for commercial borrowers or consumers. Just last year, the Fed demonstrated its willingness to rapidly push up borrowing costs if it believes there is a possibility of growing inflation. Thus, the 504 program could be needed by small businesses to maintain their long term debt needs at affordable interest rates.

Second, aside from interest rates, the Congressionally-approved authorization level provides some assurance that there will be a reasonable amount of long term capital available for growing small businesses. Typically, the first segment of the commercial market to lose access to bank borrowing in a credit crunch is small business. We see no reason why this cycle of rate decreases and increases will be any different than those of the past thirty years. As the Federal Reserve "jawbones" the private lenders about maintaining credit quality, many banks have already pulled back from lending to even the most qualified small businesses. It will be the SBA loan guaranty programs – 504 and 7(a) - that will be there for America's small businesses, when the banks have abandoned the markets that produce job growth.

Third, the program level passed by the Congress recognizes the cost-effectiveness of the 504 program. This program, the second largest loan guaranty program in the agency (and the largest economic development loan program within the Federal government), is funded entirely by user fees. There is no appropriation of taxpayer funds needed to deliver this program. Thus, it is extremely efficient, in that with no up-front appropriation, the 504 program provides added tax revenues through business expansion to all levels of government.

504 projects provide new jobs in their communities by expanding land, equipment, buildings, and job bases for our small business borrowers. In turn, this expansion leads directly to new tax bases, including:

- **City & county real estate taxes from new construction projects**
- **State & local sales taxes from increased business revenues**
- **Federal & State income taxes from new and expanding businesses**
- **Federal & State payroll taxes from new employees.**

It is clear that businesses assisted by this no-cost program are contributing to the tax surpluses that have been enjoyed by all levels of local, State, and Federal governments. Congress recognizes the value of the program and has focused on expansion of 504 at the right time during this economic slowdown.

2. 504 BORROWER FEE DECREASE

SBA's proposed FY 2002 budget decreases the annual fee charged each 504 small business borrower from 0.472% to 0.410%. This is a 13% decrease in the fee for FY 2002, which comes on top of borrower fee decreases of 11% in FY 98, 6% in FY 99, 18% in FY 2000, and 21% in FY 2001. Thus, the annual fee charged to the small business for the SBA's 504 loan annual borrower guaranty fee has declined by more than 50% over the last five years, offsetting some of the rising costs of private sector borrowing and construction during that time period.

Unfortunately, this annual borrower fee is not the only fee paid to the SBA for its loan guaranty. The first mortgage lender must also pay an up front one-time fee of 0.50%. The borrower must pay an additional 0.50% up front fee. Finally, the CDC making the loan must pay an annual fee of 0.125%. Thus, the true decline in the cost of the 504 program for the small business borrower is substantially less than 50%. In fact, the real decline in total program fees might be only about 20 - 25% since 504 went off budget.

Our industry is pleased that SBA and OMB recognize the quality of our loans to small business borrowers, and have responded with decreased estimates of the cost of this program over the past six years. A more affordable program actually helps strengthen each borrower, since the business faces lower interest and fee charges. This, in turn, actually reduces the possibility of loan defaults due to a borrower running out of cash to pay debt. Lower fees mean lower cash out of the business, higher cash reserves for emergencies, and fewer losses for SBA.

However, receiving this FY 2002 fee decrease does nothing to alleviate our long-standing concerns about how SBA and OMB come up with these critical cost model calculations.

504 LOAN PORTFOLIO PERFORMANCE

One of the primary reasons for this substantial decrease in borrower fees is the decline in SBA's and OMB's forecast of 504 loan defaults for future loans. Attached to this statement, in Chart 1, is a summary of several important 504 program cost model factors. These are NOT actual historical performance, but simply the calculations SBA and OMB arrive at for projecting their view of the cost of this program.

As Chart 1 reveals, the good news for our borrowers is the continuing and consistent decline in the annual guaranty fee they must pay to SBA for the privilege of receiving the Federal loan guaranty. However, from there on, the data on this chart becomes extremely confusing, and appears to be inconsistent with what we know of actual 504 debenture performance. We will now review our concerns in detail.

1. 504 Default Rate

The subsidy for the 504 program was eliminated in FY 1996 through implementation of a fee of 0.125%. Following that year, in FY 1997, the SBA's forecast of borrower defaults was a whopping 18.82%. At that time, we stated to the Administration and to this Committee that our independent analysis of the 504 portfolio to that point did not support this rate of defaults. Our conclusions were verified by sophisticated analysis by our major Wall Street underwriters who utilized widely accepted financial analysis tools. We now find that, five years later, and with little change in either the economy or our borrower qualification standards, OMB is using a subsidy model default rate of 11.1%. We must assume that SBA and OMB are now trying to get this figure to agree somewhat with actual historical portfolio performance.

Moreover, for FY 2002, SBA and OMB further decrease the default rate from 11.1% to only 8.41%. This is a 24.2% decrease in the program's expected default rate – in just one year. We are both pleased and perplexed. True historical performance is shown in Chart 2, attached. Note that the number of debentures issued each month has increased since 1991 from about 100 to well over 300 each month. These are actual funded loans, not just approved loans.

At the same time, monthly defaults have increased from between ten to fifteen each month to approximately fifteen to eighteen each month, a relatively insignificant increase. Thus, proportionally, the raw number of monthly defaults suggests that borrowers are *defaulting at a low and very consistent rate* over the past ten years. Why has this good and consistent performance not been recognized by SBA and OMB in the last six years of subsidy calculations?

Again, SBA appears to be finally recognizing the improved performance of our borrowers in repaying their loans. However, we must ask: what new data could SBA have uncovered that would lead to such a massive reduction of default forecasts for a program for which they have sixteen years of portfolio performance data on? Why weren't default estimates reduced earlier? Since SBA has not revealed detailed data and conclusions to NADCO, we urge this Committee to get to the bottom of these wild changes in such key program statistics. With so much portfolio performance data available from multiple sources, it would seem that SBA could accurately and consistently forecast these important factors.

2. 504 Recovery Rate

In our review of the budget assumptions, nothing surprised us more than the SBA's estimate of the FY 2002 loan recovery rate. As the Chair and Ranking Member will recall, this Committee and our industry have accomplished much together in attacking the low average recovery factor for the 504 program over the past five years.

First, we worked together to construct a Pilot Liquidation Program for 504. Beginning four years ago, the Committee required SBA to allow a pilot group of skilled and experienced CDCs to liquidate their own defaulted 504 loans. To ensure that results could be validated as unbiased, SBA established a "control group" of CDCs, whose loans are liquidated as usual by SBA field staff.

After four years, this pilot program was evaluated as a resounding success – by the Committee, the industry, and even the SBA. With most of the pilot projects being completed, the actual recovery rates for BOTH THE INDUSTRY PILOT AND THE SBA FIELD STAFF are roughly the same: 60%. This pilot has demonstrated that, when we and SBA really focus on recovering value from 504 collateral, we can obtain far better than the FY 2001 recovery rate of 31.27%. This Committee was so pleased with even the preliminary data on this pilot that Congress made this program a permanent part of the 504 program last year.

Second, again due to another pilot program success, this Committee agreed to make the Premier Certified Lender Program (PCLP) a permanent program, and allow its expansion to other qualified CDCs. Modeled after the successful 7(a) PLP program, this 504 PCLP program enables delegation of substantial lending, servicing, and even liquidation authority to qualified CDCs. In exchange for increased authority to streamline the loan process, CDCs agree to pay for the first 10% of any loss the Federal government might suffer from a 504 loan default. Thus, this immediately reduces the loan loss exposure of SBA for all loans done under PCLP. Loan volume under this program continues to grow rapidly as more CDCs seek to provide improved service to 504 borrowers and bypass the increasingly bureaucratic loan processing by SBA field staff.

Third, at the behest of OMB, SBA has undertaken a series of asset sales after foreclosures and the exercise of the federal guaranty when a borrower defaulted. This effort was modeled after the successful RTC asset sales some years ago that saved the thrift industry from complete collapse. In fact, SBA has employed many of the same firms and individuals for advice in managing these asset sales. There have been three asset sales to date, with a fourth scheduled to occur within months. Senior SBA officials have informed the industry that the vast majority of old 504-based assets and notes have been sold off to private investors through these first three sales.

We have recently been informed that the results of these three asset sales are as follows:

Sale #1:	626 loans	61.06% recovery rate
Sale #2:	96 loans	29.44% recovery rate
Sale #3:	56 loans	22.35% recovery rate

The overall average recovery rate for these 778 loans was <u>over 46%</u>, far above the FY 2002 forecast of about 26%. It also seems that the most marketable 504 loan assets were sold in the first large sale, with the poorest notes or charged off loans being sold in the latest sale. Given how few 504 loans really default, we believe future sales would be of more current and higher-yielding assets, leading to a significantly higher recovery ratio.

Given these substantial and far-reaching program improvements and the facts as detailed above, we were surprised and disheartened when we were told that the SBA forecast for our recovery rate for 504 had gone <u>DOWN</u> from FY 2001 of 31.27% to only 26.93%. This is a decline of 14% of the 2001 figure. Amazingly, this occurs in the face of improvements of every statistic related to loan recoveries for the 504 program.

With a general lack of information on real portfolio performance, it is not surprising that we cannot get verifiable information on the recoveries of assets pursued through normal traditional mechanisms by SBA liquidation field office specialists. We would hope that their efforts mirror those of the "control group" within the liquidation pilot. As stated earlier, the recovery by SBA field staff in that pilot was about 60%. This would be a reasonable expected performance level for all other loans liquidated by SBA staff. However, given no data on regular SBA field office recoveries, we urge this Committee to seek improved information on such recoveries for 504.

With this substantial decline in FY 2002 recovery estimates, it would appear that neither OMB nor SBA has factored in the program enhancements or the pilot results detailed above. We simply have no way of knowing how SBA arrived at this decreased recovery figure. However, our industry does not believe or accept this latest estimation from SBA. We ask for the Committee's help in getting to the bottom of this crucial program statistic.

3. 504 Borrower Prepayment Rate

SBA has estimated that the voluntary early prepayment of 504 loans will increase from 40.87% for FY 2001 to 49.7% for FY 2002. This is not necessarily a bad thing for the Federal government. It means that our small business borrowers are doing well. They are paying their loans off, and even doing so in advance of their loan maturity. For these payoffs, the government has earned guaranty fees throughout the life of the loan. Further, the government has not lost any money on these prepayments.

However, as Chart 1 reveals a history of SBA projections, this figure goes all over the chart. It started at barely 21%, and has gone in every direction since then. Compare these SBA estimates to the reality of actual prepaid debentures shown in Chart 2. This is true performance data provided by the Bank of New York, the 504 Trustee bank that makes all payments of principle and interest to the 504 debenture investors on Wall Street.

It is clear that prepayments climbed from the mid-1990s through 1998. These peaked at about 150 debentures per month. It is also clear that prepayments have fallen fast in the last two years. It is now less than 50% of the peak rate, and shows no sign of increasing again.

With this actual history of prepayments, we question how an INCREASED prepayment rate forecast by SBA of 49.7% is arrived at since there is an obvious decline in real debenture prepayments over the last two years. Again, this leads to concerns with the methodology by which SBA and OMB arrived at this important program statistic. Their forecast for FY 2002 seems to fly in the face of historical reality. Once again, we must ask this Committee to seek additional information from the Administration on the rate of 504 prepayments.

SBA FY 2002 PERFORMANCE PLAN

While there are several SBA goals or objectives that will eventually impact 504, we believe that two areas are of critical interest to us today. We have some comments about each area.

First, as noted by the SBA Office of the Inspector General, both agency staff and lenders must remain committed to the ***prevention of loan program abuse and fraud***. We assure this Committee that our industry stands firmly behind all efforts to prevent loan fraud. To date, SBA has attempted to put into place lender and internal agency procedures to utilize the vast resources of the IRS, the FBI, and the INS to identify applicant borrowers who might not have paid their federal taxes, may have felony convictions, or might not be in the U. S. legally.

Unfortunately, the procedures, technology, and funding have not been able to meet the operating needs of our lenders or borrowers. For any small business trying to expand, time is money. Delays in obtaining capital can cost a business valuable time and expenses, and sometimes lost opportunities. The processes SBA has developed to co-ordinate with the IRS, the FBI, and the INS are simply not working. IRS tax statement verification takes weeks. FBI background checks are frequently taking months to obtain. INS verifications many times take even longer than the FBI.

In order to maintain an acceptable level of service to small businesses, we must see improvements in the processing of information needed from the IRS, the FBI, and the INS to satisfy the SBA OIG goal. We urge the next Administrator to get to the bottom of the issues causing delays and work more effectively with other Federal agencies to improve service to small businesses.

Second, we strongly support the SBA goal of ***providing effective and efficient Information Technology support to program delivery***. We note with interest the Acting Administrator's comment before the Senate recently that he has "concluded that the LMS [Loan Monitoring System] had become co-mingled with an internally-sought Systems Modernization Initiative." He further noted that he intends to contract on a pilot basis with established financial institutions that already have operational risk management and loan monitoring systems.

NADCO has long supported this system development effort, even before it was a formal IT project within the agency. Throughout the summer of 1995, we committed weeks of time by dozens of CDC executives to participate in consultant efforts to document the necessary loan processes for 504. The intended goal was to modernize the entire 504 loan making and servicing process, improve service to borrowers and lenders, and reduce agency risk. In the years since then, we participated in several task forces and numerous meetings, hoping to see this goal achieved quickly.

However, it appears the systems developmental process within the agency may have become the goal itself. Appropriations from Congress ($8 million per year since FY 1998, according to SBA's Senate testimony) were showered upon the project far in excess of what any large financial institution would spend to complete a risk management system. After SBA's spending at least $32 million of taxpayer dollars so far on this vital system, our "outsider's view" is that we may well be no closer to a completed risk management system than we were three years ago.

Please do not misinterpret our position. We continue to strongly support the need for improved loan monitoring by the agency. However, we endorse the Acting Administrator's consideration of use of existing commercial financial applications to speed up this process. We fear that otherwise, the SBA staff and private lenders, who all want to improve borrower service while reducing taxpayer risk, will still be waiting for a system by the turn of the NEXT century.

EXPANDING 504 SERVICE TO BORROWERS

NADCO has undertaken an extensive strategic review of the 504 program during the last two years. We believe the 504 program must be dynamic and responsive to the ever-changing capital needs of small business. To meet this challenge, we are developing a series of proposals to increase the access to, and use of, the 504 program. We expect to present these ideas to the Committee shortly.

Our possible program enhancements include:

- Adding the ability to finance a purchase of stock in an existing small business when it is secured by a reasonable amount of business hard assets.
- Adjusting the size standard measurements of qualified small business borrowers to make up for almost twenty years of inflation.

- Streamlining the loan closing process by eliminating needless documentation such as the Compensation Agreement.
- Providing CDC reserves flexibility by modifying existing statute requiring use of only FDIC bank accounts for PCLP reserve funds.

These changes will be detailed through proposals from NADCO for your consideration. We look forward to working with the Committee to continue improving the program.

504 SUBSIDY: THE NEED FOR VIGILANCE

Throughout this statement, we have pointed out that we have closely monitored SBA and OMB 504 program cost and fee calculations for years. We have also noted areas wherein there appear to be major inconsistencies between SBA and OMB forecasts and 504 program historical reality. We have recounted the times that our industry has sought clarification and understanding from both this and the previous Administration, but have been rebuffed entirely or left with the impression that the data is so mysterious that only government analysts can really understand it.

Mr. Chairman and Representative Velazquez, the users of this program and the organizations who pay the fees to support the 504 program deserve to understand how the fees are calculated that they are being required to pay to the Federal Treasury. In doing the program re-estimates last year, it was clear that 504 had gone the same way as the 7(a) program: we were in "negative subsidy". That is, we were paying more into the Federal Treasury than the program actually was projected to cost. We are concerned that this situation may continue for FY 2002.

Is 0.410% the right fee for the borrower? Is 26.93% the real recovery rate for our foreclosed assets? Given the historical decline of the default rate, is 8.41% the real number, or is it even lower? Should the first mortgage lender be paying 0.50% up front, the borrower pay a guaranty fee of 0.50% up front, and the CDC be paying 0.125% each year, or is this money simply going into the Treasury, with no benefit to the borrower, the lender, or the SBA?

The SBA-OMB 504 subsidy model results have always been inconsistent with the historical record of portfolio performance. Our concern is that the accuracy of this model's projection of future portfolio performance seems to be getting worse, rather than better. Simply put, it appears to be moving away from the program's historical reality.

It has taken six long years to get SBA and OMB to recognize that our loan defaults never were really 19%. Imagine the poor small business borrower who has to pay every month for this lack of accurate forecasting by SBA. A borrower in November, 1996 paid, and will continue to pay for the next fourteen years, 0.875% EVERY YEAR for its guaranteed loan. We now know that the actual cost to the Federal government was at or less than 0.410%.

SBA and OMB are headed in the right direction by recognizing that the true cost of 504 is far less than they forecast in 1996. However, twenty thousand 504 borrowers have now paid for these inaccuracies with high and unnecessary fees that they will carry for the next fifteen to twenty years. This must stop now.

We respectfully request that the Committee get to the bottom of these wildly gyrating program statistics. We ask for a true determination of whether 504 is in negative subsidy and simply turning over excess fees to the Treasury. We are aware of a pending Congressional request to the General Accounting Office for a close analysis of the 7(a) program loan default performance. We urge the Committee to extend such a review to these 504 program subsidy model issues: default rate, recovery rate, prepayment rate, asset sale impact. It is in the best interests of America's small businesses that we all understand the program's real performance, and ensure accurate user fee calculations. The results of the last six years of subsidy calculations have not demonstrated that either SBA or OMB have a clear understanding of the program's historical costs, or can use this history to accurately forecast the future cost of the 504 program.

There are many issues to be addressed for the 504 program if we are to improve it and stabilize the declining loan recovery rate. NADCO recognizes the Committee's support for changes to improve and expand the program across America. Now, we must get SBA and OMB to recognize the true value of the many improvements implemented during the past several years. Such improvements – legislative, regulatory, and simple policy changes – have clearly enhanced the quality of our lending practices, and long term portfolio performance. Our challenge is to make the Administration recognize the value of this hard work and these positive changes.

Thank you for allowing us to provide our comments. CDCs are major stakeholders in the 504 Program and want to do everything we can to ensure its long term viability. Even though we are at zero subsidy with no appropriation, we consider the program subsidy model factors to be a very serious matter, and we look forward to working with your Committee and the SBA in clarifying these uncertainties quickly. Only through this effort can we continue to bring the 504 program fees back to reasonable levels for all small businesses.

Testimony Before the House Small Business Committee
David Means, Executive Director,
Greater Newark Business Development Consortium

Wednesday, May 16, 2001

Thank you, Mr. Chairman and members of the Committee, for the opportunity to testify before you today. My name is David Means. I am the Executive Director of Greater Newark Business Development Consortium (GNBDC) and a member of the Association for Enterprise Opportunity (AEO) the nation's only microenterprise development trade organization. My testimony represents the views of AEO as well as the Greater Newark Business Development Consortium.

I am a retired banker with thirty-three years experience. I retired as Senior Vice President responsible for Branch Administration, Operations and Legislative Relations.

My interest in community development began early in my banking career as project manager in the banks' Urban Development Housing Programs.

Today I am the director of New Jersey's leading SBA/Microloan Program. Over the past seven years, GNBDC has borrowed from the SBA, directly or indirectly $3,523,139. The GNBDC has approved and closed 207 loans with an average loan of $22,000. The default rate is 6% with fifty-seven borrowers fully repaid. ***"Make the loan, then make the loan work".***

AEO, founded in 1991, is the national association of organizations committed to microenterprise development. AEO provides over 400 organizational members with a forum, information and a voice to promote enterprise opportunity for people and communities with limited access to economic resources. A good number of AEO members are SBA Intermediaries as well as Women's Business Centers. AEO has three policy priorities for this Fiscal Year. They are to fund the SBA Microloan technical assistance and loan capital programs at $30 million each, to fund the Office of Women's Business Ownership's Women's Business Centers Program at $13.7 million, and to fund PRIME at $15 million in FY 2002. I will expand on these requests later in my testimony.

Microenterprises are small business with five or fewer employees that have difficulty accessing small amounts of credit from conventional sources. Many microentrepreneurs, particularly those served by microenterprise development organizations, are low income, women, minorities, or disabled individuals who may face other challenges to business success as well. Microenterprise is an effective economic development and self-sufficiency strategy ~~strategy~~ that ~~that~~ reduces reliance on public assistance, creates jobs, and raises the income, education levels, job skills and assets of poor and moderate-income entrepreneurs. The Aspen Institute estimates that there are at least 2 million low-income microentrepreneurs in the United States.

Locally based microenterprise development programs provide credit, training, and technical assistance to microentrepreneurs. Over the past decade, several Federal programs have emerged to provide funding support to microenterprise development programs.

As I mentioned earlier, in order to meet the demand for training, technical assistance and credit among microentrepreneurs, AEO urges Congress to support and acknowledge the distinct and complementary programs within SBA and to assist microenterprise development organizations to serve more entrepreneurs more effectively. The other small business service providers, such as the SBDCs and SCORE give assistance to small businesses with up to 500 employees. However, they differ markedly from microenterprise organizations whose primary mission is to provide specialized services to help the smallest and most disadvantaged enterprises. In addition, despite some suggestions to the contrary, these three SBA programs meet the needs of micro-entrepreneurs that no other federal programs -- not the New Markets Initiative, not the Community Development Financial Institutions Fund and not any other federal business development programs -- do. We in the microenterprise industry rely on the SBA programs to meet the needs of our clients.

Conventional sources of business credit, such as banks, are often beyond the reach of micro-entrepreneurs. These potential borrowers often seek very small amounts of capital, have poor credit histories, and can offer banks little or no collateral. The SBA Microloan Program contributes to solving this problem by providing funding to over 160 community-based intermediaries to help microentrepreneurs gain access to credit. To date, these intermediaries have made more than 12,000 microloans totaling approximately $130 million.

Since microloan borrowers require training and technical assistance to start or expand their businesses, the SBA Microloan Program also provides funding to intermediaries to offer these services. In contrast to PRIME, however, this program supports the training and technical assistance needs of *borrowers* -- and provides only a minimal amount of funds for technical assistance to individuals who do not borrow.

The SBA's Office of Women's Business Ownership (OWBO) is the only federal office that specifically targets women business owners. Its Women's Business Centers provide training and technical assistance to women starting or expanding businesses. There are a total of 92 Women's Business Centers. Fifteen new Centers were added this past year. The Centers are required to target services to economically and socially disadvantaged women, some of whom are micro-entrepreneurs. The vast majority of Center clients are women for whom participating in a targeted program is important because of the special challenges that face women in business. The Centers create opportunities for networking among women business owners and are particularly responsive to their needs. Over the past ten years, Women's Business Centers have provided consulting, training and technical assistance to more than 50,000 women.

Finally, In order to succeed in our complex economy, microentrepreneurs need training and technical assistance in areas such as financial management, bookkeeping, and marketing. Fifty of the PRIME Act's funds are to be used to support training and technical assistance for low-income entrepreneurs. Low-income entrepreneurs often require especially intensive training services and may not require loans. (In 1995, 82% of all microenterprise program clients did not take out loans.[1]) The PRIME funds will provide grants to microenterprise development organizations to offer training and technical assistance to low-income microentrepreneurs, whether or not they take out loans.

PRIME funds will also enable non-profit microenterprise organizations to build their management, outreach, and program design capacity so that they can more effectively serve low-income clients. PRIME funds can support the full range of non-profit organizations that assist microentrepreneurs, not only those organizations providing microloans.

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[1] Aspen Institute, *1999Directory of U.S. Microenterprise Programs*

In conclusion, Mr. Chairman and members, I would like to put a human face on the statistics, facts and numbers I have shared with you today.

1. **ELECTRONIC HEALTHCARE NETWORK**

Business location:	New Jersey (Home based)
Start-up date:	September 1994
Loan amount/term:	$10,000 / 4 years
Date loan paid in full:	July 1996

Letter by Borrower dated April 1995:
"Dear Mr. Means, Allow me to take this opportunity to thank you for your help and cooperation in the start-up of our small business. The GNBDC Small Business Loan Center has been indispensable to us and without it we couldn't have come this far. It is helpful to know that you are always there to help us when the need arises."

2. **JENNINGS ENTERPRISES (Vending Machine Business)**

Business location:	New Jersey
Start-up date:	November 1995
Loan amount/term:	$15,000 / 3 years
Date loan pain in full:	November 1998

Interview Comments by Borrower, 1999:
"I thank the GNBDC for their vote of confidence early in my company's development. This partnership is greatly needed for many people, especially African American males who, I believe, have historically had a difficulty time securing financial assistance from major institutions. I look forward to our continued good business relationship."

These kinds of responses are widespread throughout the 164 SBA intermediaries. Nationally, intermediaries have made over 12,420 loans for $129,962,235 million since the inception of the Microloan Program in June 1, 1992.

Thank you very much for this opportunity. I would be happy to answer any questions at the appropriate time.

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, DC 20416

June 20, 2001

Bridgette Luketin
U.S. House of Representatives
Small Business Committee
2361 Rayburn HOB
Washington, DC 20515

Dear Ms. Luketin:

Pursuant to the May 5th hearing on the U.S. Small Business Administration's (SBA) budget request for fiscal year 2002, the following statement responds to Ms. Christian-Christensen's question to Acting Administrator John Whitmore regarding SBA's asset sales program:

> To date, SBA has sold approximately 26,000 disaster home loans through its asset sales program, and has received fewer than 100 complaints from borrowers subsequent to these sales. The Agency as followed up on each of these complaints and has not found any evidence of what could be considered predatory lending practices nor any instances where a loan purchaser took an action that would not be termed to be prudent commercial loan servicing. Under the terms of the asset sale, the purchaser of an SBA loan is bound by all terms and conditions in effect at the time of loan purchase. In addition, any entity that purchases an SBA loan through the asset sales program is required to service the loan in a commercially reasonable manner.
>
> From our discussions with borrowers, it appears that most of their concerns have arisen when they requested a change to the terms and conditions of their loans (i.e., a release or exchange of collateral, subordination of the lien position on pledged collateral, a change in payment terms, etc.). When a borrower requests a change to the terms and conditions of any loan, the holder of a loan may approve the request as made, deny the request, or approve the request subject to its receipt of "consideration" from the borrower as a condition of approving the borrower's request. Depending on what change the borrower is requesting, this consideration may

Letter to Bridgette Luketin
June 20, 2001
Page Two

> take the form of an increase in the interest rate charged on the loan, a requirement that additional collateral be pledged, etc. The practice of requiring consideration for changes in the terms and conditions of a loan is a standard lending practice, and one that is engaged in by SBA when it is servicing a loan. Some confusion has occurred because some borrowers believe that the loan purchasers are more conservative in their loan servicing practices than SBA would be if faced with the same request. We have not, however, found this to be true.

I would also request that the following clarification regarding the New Markets Venture Capital program be included for the record:

> The New Markets Venture Capital program is a multi-year program with an authorization for one-time funding provided in FY 2002. The legislation is fashioned in such a manner that the technical assistance funds must be obligated in FY 2001. However, the funds will actually be disbursed over a 4-5 year period with a debenture period of 10 years.

I respectfully request that this information be included as an appendix to the testimony, or where you deem would be most appropriate. Thank you for your assistance with this matter. If you have any questions, feel free to contact me directly at 202-205-6700.

Sincerely,

Karen Hontz
Assistant Administrator for
Congressional and Legislative Affairs
(Acting)

OFFICE OF THE CHIEF FINANCIAL OFFICER

DATE: March 8, 2001

TO: Jim Boden
Finance Branch, OMB

FROM: Joe Loddo, Chief Financial Officer
Greg Walter, Deputy Chief Financial Officer

SUBJECT: 7(a) study for your review

In an effort to keep you informed, I am sending this note to you to inform you of an important item on subsidy rates. In recent years, SBA's subsidy rate model process has been the target of criticism from the industry and congressional staff resulting in the perception that our subsidy rates have been too high. Our large downward re-estimates have only served to exacerbate this perception. Despite several attempts to address this in the past, we have been unable to reach closure on any alternative which would address this.

Our Office of Financial Analysis has been conducting a group of studies in an effort to improve the accuracy in the 7(a) subsidy rate model. In order to assess the accuracy of the current model, they reviewed the historical accuracy of defaults and fees since the subsidy rate is most sensitive to these factors. It has been their finding that the accuracy of the our estimates could be improved by making some changes in the mechanics of the model. These changes, we believe, would result in a higher level of accuracy for the 7(a) estimates and would reduce the level of re-estimates both in the long and short term. This would increase the credibility of the estimation program attributed to SBA and OMB, and allow SBA to address its real mission rather than debate with our stakeholders about the technicalities of a model.

SBA would like to incorporate the results of this study into our modeling for the FY 2003 budget. I am enclosing this study for review and comment by your staff. In accordance with our understanding regarding timely feedback, I would like to have your staff comment to our Director of Financial Analysis, Fred Rubin, no later than 3/31/01. Your response will allow us to do any additional work needed in time for our modeling process to begin for the next budget.

Thank you for your continued support. Please contact Fred at 202-205-6122 to provide your feedback on this.

A Study Of The SBA's Default Estimation Method For The 7(A) General Business Guaranteed Loan Program -DRAFT-

Purpose:

In response to the growing concern that SBA's development methodology for default estimation in the 7(a) program projects a default rate that is too high, SBA's Office of Financial Analysis conducted a study of the method's accuracy in order to back-test the method currently used to develop expected default rates and timing. In testing the current method, SBA also compared the results of different observation periods to see if a more accurate method could be easily and explainably produced. This memo presents the results of those tests, and recommends other methods available for use, which may help the agency improve accuracy of its overall 7(a) subsidy rate estimation. These tests were conducted according to the guidelines established and required by Technical Release 3, a document pending approval in the Accounting and Auditing Policy Council.

Background:

The Federal Credit Reform Act (FCRA), effective in FY 1992 requires SBA to estimate the long-term cost of the lending programs to the government. Credit Reform, as a law, lists only intent to accurately estimate the cost of the program, and provides that the Director of OMB shall "annually review the performance of outstanding direct loans and loan guarantees to improve estimates of costs." It does not provide that the cost estimate should be conservative or aggressive in order to ensure that funding is available in years where the economy is not at its strongest.

In 1995 and 1996, SBA developed a database to aid in the task of assessing loan performance. The database, which came to be named MONSTER, was initially completed in 1996. All cashflow transactions which accrue to the cohort(s) are loaded into the database, which now covers a period of 15 years (with exceptions for the period of 1988 and prior). This data is available on a transactional basis to October 1, 1988 (constituting FY 1989), and is supplemented by extrapolated purchases to October 1, 1985 (FY 1986). In addition, the database contains approximately 25 fields of information regarding the characteristic aspects of the loan such as the SIC grouping, region, and loan type as of the fiscal year ends. This covers all "cohorts" beginning in the FY 1986 to present, or a period of 15 years. Following the 3rd and 4th quarters of each fiscal year new data, constituting a summary of annual activity, is loaded for the current cohort and all the previous cohorts.

SBA's cashflow projection model uses approximately 12 inputs which can be categorized into 4 groups. Group 1 consists of characteristics regarding loan mix, such as the average size and loan size distribution. These primarily drive the projections for fees. Group 2 are the performance variables, and include default behavior, recoveries on those defaults, and prepayments. Group 3 are activity inputs, and include cancellations and the disbursement rate, which affect the subsidy rate minimally. Finally, there are statutory-driven inputs such as fee rates. Of all of these inputs, the subsidy rate is most sensitive to the default rate, with the subsidy changing .30% for each 1% change in the total default rate.

SBA currently derives its default curves from this database. The annual purchases are divided by SBA share of disbursements to derive default behavior on a cohort by cohort basis. The results of each year of a cohort's life are then averaged, without weighting, to derive the projected purchase behavior that is expected in a cohort's life, on an annual summary basis.

The vast majority of SBA's defaults occur in the first 6 years. After that time, the slope of the default curve is relatively flat. In the most recent period, loans which were still guaranteed and

Fred Rubin
Office of Financial Analysis
202-205-6122

undefaulted after 6 years defaulted at a rate of only about 1%, compared with peak years of 3 and 4, where defaults occur at a rate of about 3.6% and 3.2% respectively. Because the majority of defaults occur during this period, this is the most critical time for accuracy. Following this period, differences matter less both due to magnitude and the time value which occurs due to discounting.

The main criticism of SBA's default rate results from a variety of factors that are both analytical and non-analytical. Starting with the 1997 Budget, SBA began re-estimating its 7(a) subsidy rates as required by FCRA. Although the initial re-estimate was $58 million upward, all other re-estimates have been downward. A complete list of re-estimates is included in the attachments. The cumulative re-estimates now total over $1 billion, representing more than 50% of the original appropriations for this program. CBO has recently (September, 2000) issued a report on subsidy re-estimates, which cites the high level of re-estimates compared to the program's original subsidy rates. Additionally, industry groups (i.e. NAGGL) and congressional staff have decried the accuracy of the default curve based on the re-estimates, actual performance in recent years, and reportedly independent analyses conducted by contractors in order to argue for lower fees.

Testing the Original Method:

In conducting our first test, SBA used the monster data available on purchases and SBA share of disbursements as of June 2000 (annualized). Default projections were retrieved from each of the original estimation models beginning with those built using MONSTER, in other words, curves from 1996 forward were examined. This gave us 5 years of actual defaults to compare with the projected defaults, all using exactly the same data.

The default curves were transferred from the original estimation model, and compared to the actual results on a year-by-year basis in order to derive a simple measure of fit. In short, we found that, on average, the difference between actual default rates and estimated default rates for the 5 year period amounted to over 2.5%, a significant difference given the short time period examined, and a total estimated default rate of 13%-17% . Equally significant, a year by year analysis yielded the result that current projection method produces differences from actual by as much as a 400% difference, but normal differences were in the area of 100%.

It should be noted that SBA used only data that would have been available at the time of the preparation of the budget, that is for FY 1998, data would only be available as of June or September of 1996, and so on.

Testing Other Hypotheses:

Once the results of the baseline test were known, SBA attempted several other tests to ascertain if a more accurate result could be derived using a more recent data set. First, the average default calculation was limited to the 5 most recent observations (each year being one observation)[1]. This hypothetical period was chosen because the database development was completed during that year, and thus, this particular method would not have been available prior to that year. Also, we chose this period based on the knowledge that loans made more recently would be more homogeneous in that they were originated and serviced more similarly to the group being projected. SBA currently uses the last 5 years of data to predict loan structure (guarantee levels, loan size distribution and average size). Commercial Banks and US Financial institutions generally use a period of 2-5 years for similar functions such as provisioning for bad debt. Under OMB guidance, SBA uses 5 years as a legitimate predictor for disaster loan levels, which are inherently affected by indicators of macro-economic performance.

The choice of a test group originated later is fully supported by conclusions of an OCC study, which that concludes that, SBA changed its servicing and underwriting behavior upon implementation of the FCRA, based on multi-variate discrete time hazard modeling. Additionally, using this period is intuitively supported by changes in legislation such as lower maximum guarantee levels enacted in 1996. This may be because this period more closely reflects the weighted average life of the 7(a) cohorts of the last few years.

Most economists agree that the economy of the most recent years is most indicative of the near future, not withstanding unpredictable items such as recessions. That is not to say that the economy is not volatile and could be dramatically different; however, accuracy alone was the single item measured. As a result, we used the most recent 5 years of loan production because new loans would have the highest probability of being originated under similar economic conditions as those in a cohort yet to be originated. This is entirely consistent with the information published in the President's Economic Assumptions which accompany the President's Budget for the United States.

It should be noted that SBA used only data that would have been available at the time of the preparation of the budget, that is for FY 1998, data would only be available as of June or September of 1996, and so on.

The results of the first modification showed significantly higher levels of accuracy for the 5 year period examined than for the current method. The average error improved, with an error of 2.42% for the original curve, and an average error of only 1.77% (out of a total default curve of 11.4% projected over that 5 year period). More importantly, on a percentage basis the average error was reduced from 123% to 69% of the total defaults experienced over that period. In other words, the current long term method is likely to produce results that are more than one and a half times as inaccurate as the 5 year window. It should also be noted that this method still produces curves that are higher than the actual performance, allowing for some consideration of conservatism, if that is desired by policy. The results for this test are shown in the attachments.

In order to test the hypothesis further, SBA attempted a more extreme version of the second test, using a 3 year period. The results of the second test were more dramatic, and were consistent with the findings of the first alternate test. The average error improved dramatically (even over the 5 year test), with an error of 2.42% for the original curve versus an average error of only .89%. Additionally, the average error was reduced from 123% to 35% of the total defaults experienced over that period, or better by a factor of 3.5x. This method also produced curves that were, to some extent, conservative in that they exceeded the actual performance for each year examined. The results for this test are also shown in the attachments.

We also tested this method with a 7 year observation period, but the results were less accurate, as one could have expected.

Using one of these modifications might be of concern with regard to its accuracy during unpredictable economic times. In order to understand the adjusted methods' results during a recession, we tested the method by injecting an unexpected upward movement of 15% into the data used for the 5 year test. One year of the data, usually the highest value but not the earliest or latest observation, was multiplied by a factor of 1.15%. This had no significant effect on the outcome. We think that this would have been the case even if the earliest or latest year had been chosen, but we chose to exclude the earliest or latest year assuming that in either case, originating lending partners would have tightened lending criteria which should actually produce lower levels of default, albeit somewhat arbitrarily or artificially.

An additional test was conducted to determine if locking in a fixed lookback period of 14 years would result in incremental accuracy over the current method. This test showed that although some marginal improvement was noted in years 1 and 2, years 3 through 5 yielded less accuracy than the current model, and to a degree high enough to offset improvements in years 1 and 2.

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202-205-6122
03/08/01

Conclusions and Options:

This represents the first available testing of SBA's default projection method which can reasonably assess the accuracy of loans during the seasoning period. The tests conducted above lead to a poor conclusion regarding the accuracy of the current method of developing default assumptions using 15 years of data. This method produces higher levels of error than desired which are inconsistent in direction and result in large re-estimates. Fundamental to this paper was the underlying assumption that credit agencies would benefit from increasing initial estimate accuracy in order to reduce annual re-estimates, not withstanding the possibility that unpredicted economic situations could create larger upward re-estimates on some occasions (although this would occur infrequently, according to the average economic cycle).

Better accuracy can be achieved using a different observation period. This methodology retains its level of accuracy quite well in a variety of scenarios, including shock testing which should simulate an increase in purchases as is assumed would occur in a time of economic decline. It is more consistent with the normal production outcomes listed in the President's Economic Assumptions that accompany the President's Budget. Finally, it should result in re-estimates of lower magnitude and more stable direction, which are desirable in the external domain. As a result, it should be considered a viable option for preparing future budget estimates and re-estimates. Several Options should be considered:

- The best results were derived using a 3 observation window. This method produces the highest level of accuracy. However, this option will, from time to time, create higher upward re-estimates, and possibly more volatility over time.

- Reducing the default lookback period to the most recent 5 observations, which reduces inaccuracy, but defers to a policy desiring some inaccuracy in order to create cushion in the subsidy account in the case of an adverse economic environment. It may be desirable to shorten this window if 2 recessions are encountered during the observation cycle as this would be considered uncommon.

Based on the foregoing, the writer recommends that the SBA adopt a 5 year observation window in estimating defaults within the 7(a) model for budget years commencing FY 2003.

[1] In this paper, we should make the distinction between an observation period and a lookback period. SBA commonly uses the term "lookback period" to mean which cohorts will be used in the data. In this paper, we used "observations" to represent the number of years prior to the cohort that will be used, so that eliminating cohorts is not an option. Rather, using only the time periods which produce the best predictions will be used from those cohorts.

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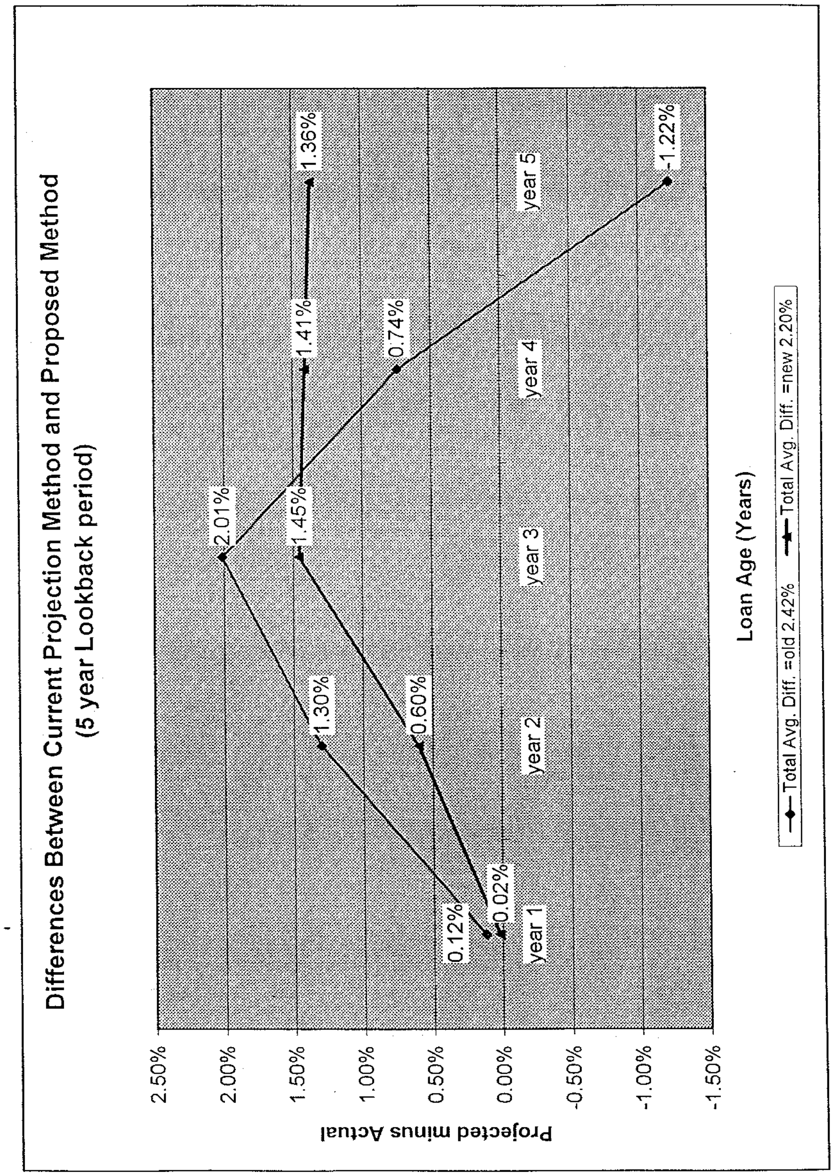
202-205-6122
03/08/01

First Line — Projection made using current method
Second Line — difference between actual and projection
third line — New Projection using last 5 years of data available at time of budget preparation
4th line — difference between actual and new projection using last 5 years of data

			--Year 1	--Year 2	--Year 3	--Year 4	--Year 5	--Year 6	--Year 7	--Year 8	--Year 9	--Year 10	--Year 11	--Year 12	--Year 13	--Year 14
	1996	17.26%	0.46%	3.02%	4.23%	2.09%	0.46%	4.29%	0.90%	0.68%	1.05%	0.08%				
Actual			0.03%	0.94%	2.33%	2.21%	1.68%									
diff		3.06%	0.43%	2.08%	1.90%	-0.12%	-1.22%									
last 5			0.07%	1.77%	4.03%	3.96%	3.05%									
diff		5.67%	0.04%	0.82%	1.70%	1.74%	1.36%									
	1997	17.25%	0.06%	1.83%	4.31%	3.82%	2.66%	1.71%	1.05%	0.62%	0.35%	0.23%	0.11%	0.17%	0.18%	0.10%
Actual			0.02%	0.78%	1.94%	2.22%										
diff		5.06%	0.04%	1.05%	2.37%	1.60%										
last 5			0.05%	1.38%	3.36%	3.29%										
diff		3.12%	0.02%	0.61%	1.42%	1.07%										
	1998	16.00%	0.09%	1.80%	3.89%	3.47%	2.45%	1.62%	1.03%	0.60%	0.35%	0.25%	0.14%	0.12%	0.04%	0.10%
Actual			0.05%	0.88%	2.12%											
diff		2.73%	0.03%	0.93%	1.77%											
last 5			0.05%	1.38%	3.36%											
diff		1.74%	-0.01%	0.51%	1.25%											
	1999	15.05%	0.07%	1.77%	3.88%	3.41%	2.31%	1.51%	0.91%	0.51%	0.27%	0.18%	0.11%	0.09%	0.03%	
Actual			0.03%	0.63%												
diff		1.18%	0.04%	1.14%												
last 5			0.04%	1.09%												
diff		0.46%	0.01%	0.45%												
	2000	14.42%	0.07%	1.75%	3.71%	3.24%	2.19%	1.43%	0.85%	0.48%	0.27%	0.18%	0.09%	0.09%	0.05%	0.02%
Actual			0.02%													
diff		0.05%	0.05%													
last 5			0.04%													
diff		0.03%	0.03%													

Recap; uses only 1996 through present

	Total	year 1	year 2	year 3	year 4	year 5
Total Avg. Diff. =old	2.42%	0.12%	1.30%	2.01%	0.74%	-1.22%
Total Avg. Diff. =new	2.20%	0.02%	0.60%	1.45%	1.41%	1.36%

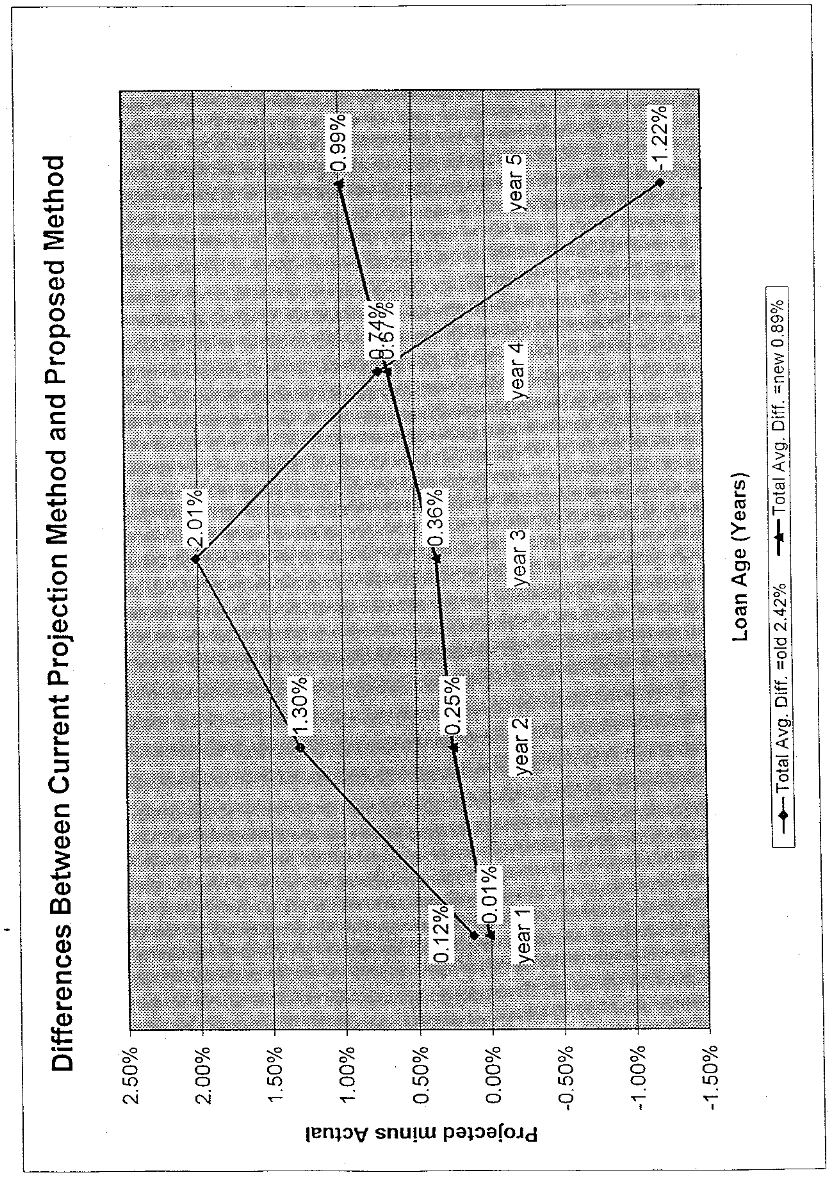

Differences Between Current Projection Method and Proposed Method
(5 year Lookback period)
Projected minus Actual
2.50%
2.00%
1.50%
1.00%
0.50%
0.00%
-0.50%
-1.00%
-1.50%
0.12%
0.02%
1.30%
0.60%
2.01%
1.45%
1.41%
0.74%
1.36%
-1.22%
year 1
year 2
year 3
year 4
year 5
Loan Age (Years)
Total Avg. Diff. =old 2.42%
Total Avg. Diff. =new 2.20%

First Line	Projection made using current method
Second Line	difference between actual and projection
third line	New Projection using last 3 years of data available at time of budget preparation
4th line	difference between actual and new projection using last 3 years of data

			--Year 1	--Year 2	--Year 3	--Year 4	--Year 5	--Year 6	--Year 7	--Year 8	--Year 9	--Year 10	--Year 11	--Year 12	--Year 13	--Year 14
	1996	17.26%	0.46%	3.02%	4.23%	2.09%	0.46%	4.29%	0.90%	0.68%	1.05%	0.08%				
Actual			0.03%	0.94%	2.33%	2.21%	1.68%									
diff		3.06%	0.43%	2.08%	1.90%	-0.12%	-1.22%									
last 3			0.05%	1.10%	2.82%	3.26%	2.68%									
diff		2.70%	0.02%	0.16%	0.48%	1.05%	0.99%									
	1997	17.25%	0.06%	1.83%	4.31%	3.82%	2.66%	1.71%	1.05%	0.62%	0.35%	0.23%	0.11%	0.17%	0.18%	0.10%
Actual			0.02%	0.78%	1.94%	2.22%										
diff		5.06%	0.04%	1.05%	2.37%	1.60%										
last 3			0.05%	1.05%	2.32%	2.52%										
diff		0.97%	0.02%	0.27%	0.38%	0.30%										
	1998	16.00%	0.09%	1.80%	3.89%	3.47%	2.45%	1.62%	1.03%	0.60%	0.35%	0.25%	0.14%	0.12%	0.04%	0.10%
Actual			0.05%	0.88%	2.12%											
diff		2.73%	0.03%	0.93%	1.77%											
last 3			0.05%	1.05%	2.32%											
diff		0.37%	-0.01%	0.17%	0.21%											
	1999	15.05%	0.07%	1.77%	3.88%	3.41%	2.31%	1.51%	0.91%	0.51%	0.27%	0.18%	0.11%	0.09%	0.03%	
Actual			0.03%	0.63%												
diff		1.18%	0.04%	1.14%												
last 3			0.03%	1.05%												
diff		0.42%	0.01%	0.41%												
	2000	14.42%	0.07%	1.75%	3.71%	3.24%	2.19%	1.43%	0.85%	0.48%	0.27%	0.18%	0.09%	0.09%	0.05%	0.02%
Actual			0.02%													
diff		0.05%	0.05%													
last 3			0.03%													
diff		0.02%	0.02%													

Recap; uses only 1996 through present

	Total	year 1	year 2	year 3	year 4	year 5
Total Avg. Diff. =old	2.42%	0.12%	1.30%	2.01%	0.74%	-1.22%
Total Avg. Diff. =new	0.89%	0.01%	0.25%	0.36%	0.67%	0.99%



Differences Between Current Projection Method and Proposed Method
Projected minus Actual
2.50%
2.00%
1.50%
1.00%
0.50%
0.00%
-0.50%
-1.00%
-1.50%
0.12%
0.01%
1.30%
0.25%
2.01%
0.36%
0.74%
0.67%
0.99%
-1.22%
year 1
year 2
year 3
year 4
year 5
Loan Age (Years)
Total Avg. Diff. =old 2.42%
Total Avg. Diff. =new 0.89%

A Study Of The SBA's Fee Estimation Method
For The 7(A) General Business Guaranteed Loan Program
-DRAFT-

Purpose:

As a part of an overall study of our 7(a) subsidy rate modeling, SBA's Office of Financial Analysis conducted a study of the current method to ascertain the level of accuracy, and develop alternative methods of modeling which would improve accuracy. This memo presents the results of those tests, which may help the agency improve accuracy of its overall 7(a) subsidy rate estimation. These tests were conducted according to the guidelines established and required by Technical Release 3, a document pending approval in the Accounting and Auditing Policy Council.

Background:

The Federal Credit Reform Act (FCRA), effective in FY 1992, requires SBA to estimate the long-term cost of the lending programs to the government. Credit Reform, as a law, lists only intent to accurately estimate the cost of the program, and provides that the Director of OMB shall "annually review the performance of outstanding direct loans and loan guarantees to improve estimates of costs." It does not provide that the cost estimate should be conservative or aggressive in order to ensure that funding is available in years where the economy is not at its strongest.

SBA charges several different fees for the guarantee of a 7(a) loan, including an upfront fee, and annual fee that began in with the 1996 cohort, a secondary market fee, and a prepayment penalty (which was initiated in FY 2001). A chart showing these is attached. This analysis focuses on the upfront and ongoing fees, since the prepayment penalty is too new to study, and the secondary market fee is marginal and has essentially no effect on the subsidy rate at this time.

These fees are affected by 2 major items. That is, the upfront fee is affected by the size and maturity of the loans, as those with original maturity under 1 year carry only a nominal fee of .25%. Loans with an original maturity of over one year carry a graduated, layered fee rate ranging from 2% (although the lender may keep 50 basis points of this, therefore, SBA nets 1.5%) to 3.5%. Thus, accuracy is a factor of the agency's ability to estimate the percent of loans that will be disbursed with an original maturity of one year or less, and then for those that are one year are more, their size. Changes in program delivery must be factored into this prediction, and even in the best of situations where information is readily available and accurate, the cause and effects are generally wrong to some degree.

The current method of estimating the loan size and maturity mix uses the database to find the average mix of the portfolio since 1996. This period is used since the maximum loan amount was temporarily capped in 1996-1997 due to estimated shortages in program level, and because the maximum guarantee percentage changed, thus affecting the mix.

SBA's cashflow projection model uses approximately 12 inputs which can be categorized into 4 groups. Group 1 consists of characteristics regarding loan mix, such as the average size and loan size distribution. These primarily drive the projections for fees. Group 2 are the performance variables, and include default behavior, recoveries on those defaults, and prepayments. Group 3 are activity inputs, and include cancellations and the disbursement rate, which affect the subsidy rate minimally. Finally, there are statutory-driven inputs such as fee rates. The model is highly sensitive to upfront and ongoing fees, which represent approximately $207 million and $144 million, respectively, over the lifetime of the 2001 cohort.

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202-205-6122
02/28/01

Testing the Original Method:

In conducting our test, SBA used the monster data available on upfront and ongoing fees and compared these to SBA share of disbursements as of June 2000 (annualized). Fee projections were retrieved from each of the original estimation models beginning with those built using MONSTER, in other words, curves from 1996 forward were examined. This gave us 5 years of actual fees to compare with the projected fees, all using exactly the same data.

The estimated fees, in dollars, were transferred from the original estimation model, and compared to the actual results on a year-by-year basis in order to derive a simple determination of accuracy. In short, we found that, on average, the difference between actual fees and estimated fees for the 5 year period amounted to a significant difference given the short time period examined. We determined that the cause of the difference was poor estimation in loan mix, specifically in the amount estimated to be less than one year. This is shown in the attachments.

In 1998 and prior, SBA estimated that only 1% of total disbursements would be from loans with original maturity of one year or less (short term loans). In successive years, however, as more data became available on this variable, SBA raised this expectation, resulting in a lower estimate of fees. As a result, we expect that the differences caused in subsidy rates should be minimized in the future, and probably without marked change in the estimation method.

It should be noted that short term loans not only affect the overall fee collections in the upfront category. Because these loans were to have been of the average maturity, their ongoing fee income is lost as well.

Conclusions and Options:

This represents the first available testing of SBA's fee projection method which can reasonably assess the accuracy of loans during the seasoning period. The tests conducted above lead to a poor conclusion regarding the accuracy of the current method of developing fee assumptions, but also lead us to believe that these estimates should improve given the most recent process used to reach estimated assumptions for loan mix. Therefore, the current method should be considered adequate at this time and subjected to study again periodically.

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202-205-6122
02/28/01
feestudy.doc

Comparison of Actual and Projected Fees
1997 to Present
7a program

		Year 1	Year 2	Year 3
1997 Cohort				
	Upfront	**201.24**	**110.68**	**90.56**
	Actual Received	**128.30**	**36.55**	**1.44**
		63.76%	33.03%	1.59%
	Interest pass through	**184.16**	**29.56**	**27.41**
	Actual Received	**4.92**	**21.59**	**21.49**
		2.67%	73.05%	78.41%

		Year 1	Year 2	Year 3
1998 Cohort	***Fees: For re-estimates, combined**			
	(1) Upfront fees received (+)	**100.34**		
182	(2) Upfront fees received (+)		**82.10**	0
	Projected Received	**100**	**82**	**0**
161	**Actual Received**	**128**	**33**	**0**
		128%	40%	
63	(1) Annual interest pass through (+)	7.75	14.39	11.92
50.95	(2) Annual interest pass through (+)		6.34	11.76
	Projected Received	**7.75**	**20.73**	**23.68**
	Actual Received	**5.09**	**20.94**	**12.81**
		66%	101%	54%

1999 Cohort				
0.53	(1) Upfront fees received (1 year and under)	0.29		
	(2) Upfront fees received (1 year and under)		0.24	
218	(1) Upfront fees received (+)	120.04		
	(2) Upfront fees received (+)		98.21	
	Projected Received	**120.33**	**98.45**	**0**
	Actual Received	**150.93**	**32.36**	
		125.43%	32.87%	
	* Annual fee:			
74	(1) Annual interest pass through (+)	9.58	17.73	14.62
60	(2) Annual interest pass through (+)	0	7.83	14.49
	Projected Received	**9.58**	**25.56**	**29.11**
	Actual Received	**5.71**	**13.58**	
		59.56%	53.13%	

Loans Disbursed by Amount under 1 yr

FY	Projected	Actual
1989		3.87%
1990		3.43%
1991		4.38%
1992		3.69%
1993		3.99%
1994		6.10%
1995		4.09%
1996	1.00%	6.01%
1997	1.00%	6.55%
1998	1.00%	7.33%
1999	2.75%	5.61%
2000	3.97%	3.58%
2001		5.81%

Description of fees for the 7(a) Program

The 7(a) Program has an upfront fee, an annual fee, secondary market fees and a prepayment penalty. The upfront guaranty fee varies based on the term of the loan and its size. Prior to December 2000, the upfront fee was determined as follows:

- The guaranty fee on a loan with a maturity of twelve months or less is 0.25%.
- There was a 2% upfront fee on the SBA share of $80,000 or less.
- A 3% fee was assessed on the guaranteed portion that exceeds $80,000 but is $250,000 or less.
- SBA guarantees that exceed $250,000, but are less than $500,000 carried a 3.5% fee on the amount over $250,000.
- The upfront fee on amounts guaranteed above $500,000 was 3.875%.

In December 2000, congress authorized a change in these fees to encourage lenders to originate more small loans, and to simplify the fee structure in order to reduce the processing cost to our private sector lending partners. The new fee structure eliminates the complex "layering" effect, and allows lenders to retain part of the fee. Specifically, the new fee structure is:

- The guaranty fee on a loan with a maturity of twelve months or less remains 0.25%.
- For loans with a total loan amount of $150,000 or less, a fee of 2% is charged on the guaranteed portion. The lender may retain up to 25% of the upfront fee, providing SBA a net fee of 1.5%.
- For loans with a total loan amount of more than $150,000 but $700,000 or less, a fee of 3% is charged on the guaranteed portion.
- For loans with a total loan amount of more than $700,000, a fee of 3.5% is charged on the guaranteed portion.

Since 1996, lenders have paid a 50 basis point annual fee that is calculated based on the SBA share of the outstanding balance. The secondary market fee is a one-time fee on all loans sold in the secondary market equal to one-half of the premium in excess of 110 percent of the outstanding balance on all loans sold in the secondary market.

As of December 2000, loans with an original maturity of 15 years or greater also became subject to a prepayment penalty, if over 25% of the loan is prepaid in the first 3 years. The prepayment penalty would be equal to 5%, 3% and 1% of the prepaid amount if paid in 1 year, 2 years or 3 years of disbursement, respectively.

Reestimate Summary
DRAFT

7a Reestimate Amount *(Dollars in Thousands)*
Includes principal only and Technical Re-estimates

	1997 Budget	1998 Budget	1999 Budget	2000 Budget	2001 Budget	2002 Budget	umulative Change
1992 Cohort	$ 4,699	$ (55,388)	$ (29,806)	$ (73,695)	$ (4,711)	(4,183)	$ (163,084)
1993 Cohort	$ (14,139)	$ (77,011)	$ (50,462)	$ (79,558)	$ (21,398)	(16,085)	$ (258,653)
1994 Cohort	$ 52,891	$ (13,610)	$ (62,959)	$ (60,366)	$ (11,505)	(4,376)	$ (99,925)
1995 Cohort	$ 10,547	$ 48,620	$ (68,391)	$ (59,836)	$ (774)	(3,619)	$ (73,453)
1996 Cohort		$ 32,401	$ 37,280	$ (101,090)	$ (15,994)	(9,349)	$ (56,752)
1997 Cohort			$ (23,836)	$ (86,258)	$ (38,550)	(133)	$ (148,777)
1998 Cohort				$ (52,221)	$ (38,744)	(39,467)	$ (130,432)
1999 Cohort					$ (13,018)	(11,392)	$ (24,410)
2000 Cohort						(2,526)	$ (2,526)
Total Change	$ 53,998	$ (64,988.00)	$ (198,174)	$ (513,024)	$ (144,694)	$ (91,130)	$ (958,012)

2000 Re-estimate Amount *(Dollars in Thousands)*

Total Re-estimate	$ 53,998	$ (64,988)	$ (198,174)	$ (513,024)	$ (144,694)	$ (91,130)
Total Interest		$ (35,092)	$ (78,711)	$ (133,786)	$ (30,245)	$ (26,394)
Total Re-estimate Amount		$ (100,080)	$ (276,885)	$ (646,810)	$ (174,939)	$ (117,524)

7a Subsidy Rate Reestimates

	Execution Rate	1997 Budget	1998 Budget	1999 Budget	2000 Budget	2001 Budget	2002 Budget
Cohort 1992 (Technical)	4.85%	4.94%	3.88%	3.31%	1.90%	1.81%	1.73%
(Interest)		5.38%	5.38%				
Cohort 1993 (Technical)	5.21%	4.97%	3.67%	2.82%	1.48%	1.12%	1.06%
(Interest)		5.43%	5.43%				
Cohort 1994 (Technical)	2.15%	2.91%	2.70%	1.82%	0.98%	0.82%	0.76%
(Interest)		2.19%	2.19%				
Cohort 1995 (Technical)	2.74%	2.97%	3.61%	2.61%	1.77%	1.76%	1.71%
(Interest)		2.95%	2.97%				
Cohort 1996 (Technical)	1.06%		2.40%	2.17%	0.58%	0.34%	0.20%
(Interest)			1.07%	1.06%			
Cohort 1997 (Technical)	1.93%			1.39%	0.44%	0.02%	0.03%
(Interest)						2.23%	
Cohort 1998 (Technical)	2.14%				1.00%	0.88%	0.41%
(Interest)						1.23%	
Cohort 1999 (Technical)	1.39%					1.03%	1.12%
(Interest)						1.37%	0.89%
Cohort 2000 (Technical)	1.16%						1.10%
(Interest)							

Reestimate Summary
DRAFT

7a Reestimate Amount *(Dollars in Thousands)*
Includes Interest and Technical Re-estimates, plus interest on re-estimates

	1997 Budget	1998 Budget	1999 Budget	2000 Budget	2001 Budget	2002 Budget	Cumulative Change
1992 Cohort	$ 5,922	$ (74,698)	$ (43,054)	$ (73,695)	$ (7,798)	(7,415)	$ (200,737)
1993 Cohort	$ (16,441)	$ (97,512)	$ (66,840)	$ (79,558)	$ (30,307)	(25,716)	$ (316,374)
1994 Cohort	$ 58,070	$ (15,920)	$ (80,216)	$ (60,366)	$ (16,394)	(6,665)	$ (121,490)
1995 Cohort	$ 11,186	$ 53,854	$ (101,952)	$ (59,836)	$ (1,036)	(5,207)	$ (102,990)
1996 Cohort		$ 34,195	$ 40,357	$ (101,090)	$ (19,520)	(12,174)	$ (58,232)
1997 Cohort			$ (25,181)	$ (86,258)	$ (43,342)	(162)	$ (154,944)
1998 Cohort				$ (52,221)	$ (42,451)	(45,149)	$ (139,821)
1999 Cohort					$ (13,634)	(12,376)	$ (26,010)
2000 Cohort						(2,661)	$ (2,661)
Total Change	$ 58,737	$ (100,081)	$ (276,885)	$ (513,024)	$ (174,481)	$ (117,524)	$ (1,123,259)

7a Subsidy Rate Reestimates

	Execution Rate	1997 Budget	1998 Budget	1999 Budget	2000 Budget	2001 Budget	2002 Budget
Cohort 1992 (Technical)	4.85%	4.94%	3.88%	3.31%	1.90%	1.81%	1.73%
(Interest)		5.38%	5.38%				
Cohort 1993 (Technical)	5.21%	4.97%	3.67%	2.82%	1.48%	1.12%	1.06%
(Interest)		5.43%	5.43%				
Cohort 1994 (Technical)	2.15%	2.91%	2.70%	1.82%	0.98%	0.82%	0.76%
(Interest)		2.19%	2.19%				
Cohort 1995 (Technical)	2.74%	2.97%	3.61%	2.61%	1.77%	1.76%	1.71%
(Interest)		2.95%	2.97%				
Cohort 1996 (Technical)	1.06%		2.40%	2.17%	0.58%	0.34%	0.20%
(Interest)			1.07%	1.06%			
Cohort 1997 (Technical)	1.93%			1.39%	0.44%	0.02%	0.03%
(Interest)						2.23%	
Cohort 1998 (Technical)	2.14%				1.00%	0.88%	0.41%
(Interest)						1.23%	
Cohort 1999 (Technical)	1.39%					1.03%	1.12%
(Interest)						1.37%	0.89%
Cohort 2000 (Technical)	1.16%						1.10%
(Interest)							

Chart1

Default Trends for Loans Aged One Year

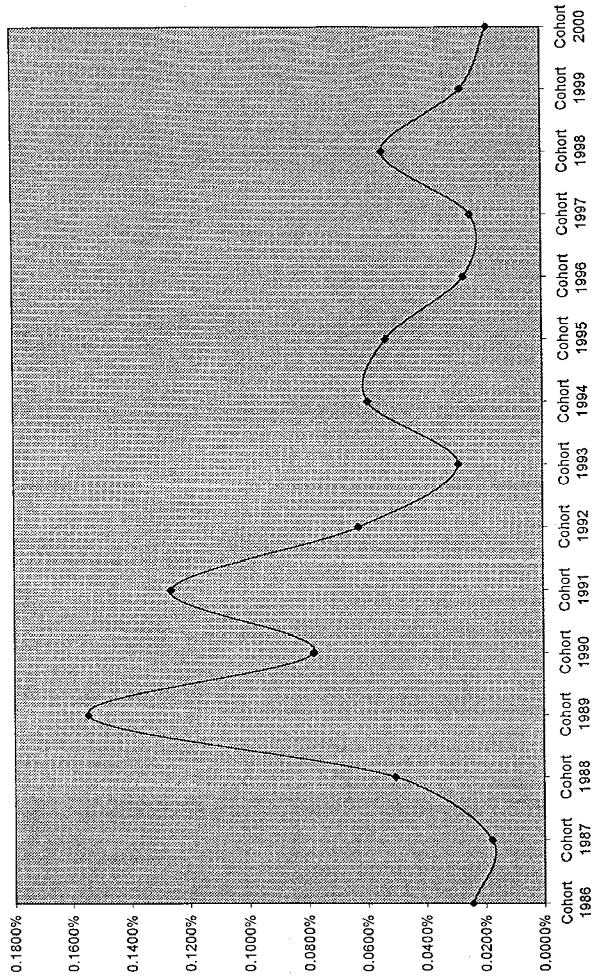


Chart2

Defaulted Trend for Loans Aged 2 Years

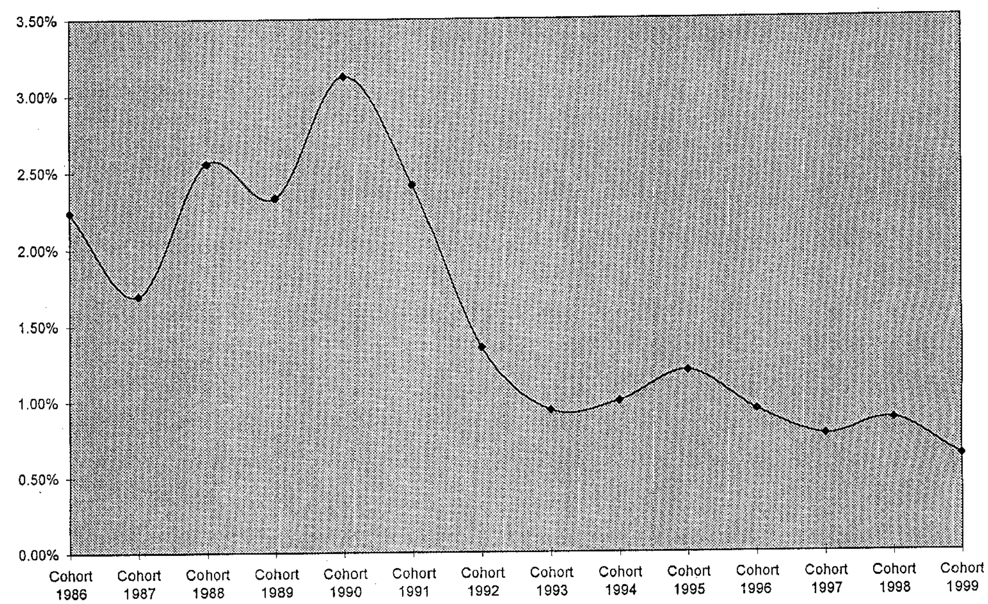
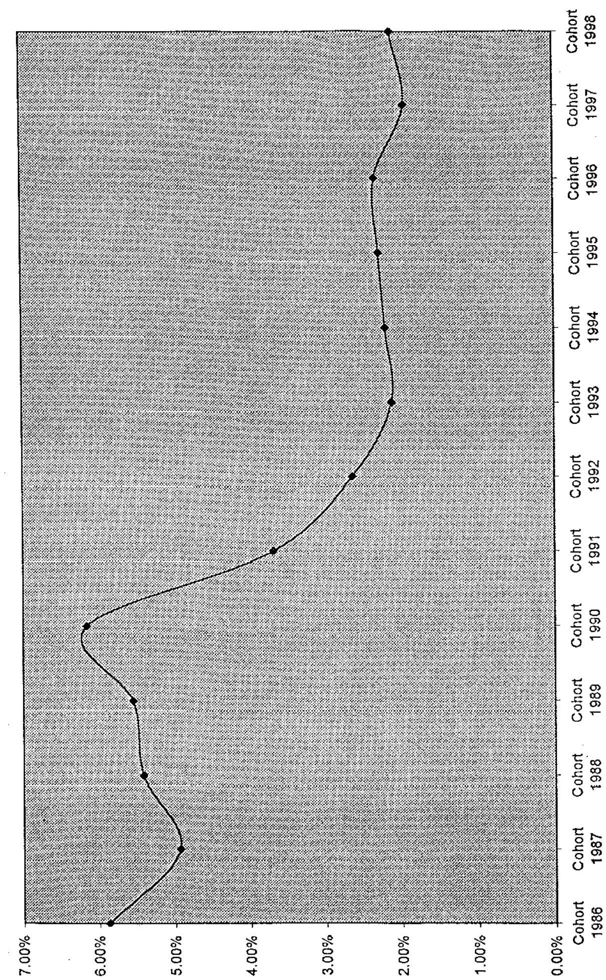


Chart3

Default Trend for Loans Aged 3 Years



Page 3

Chart4

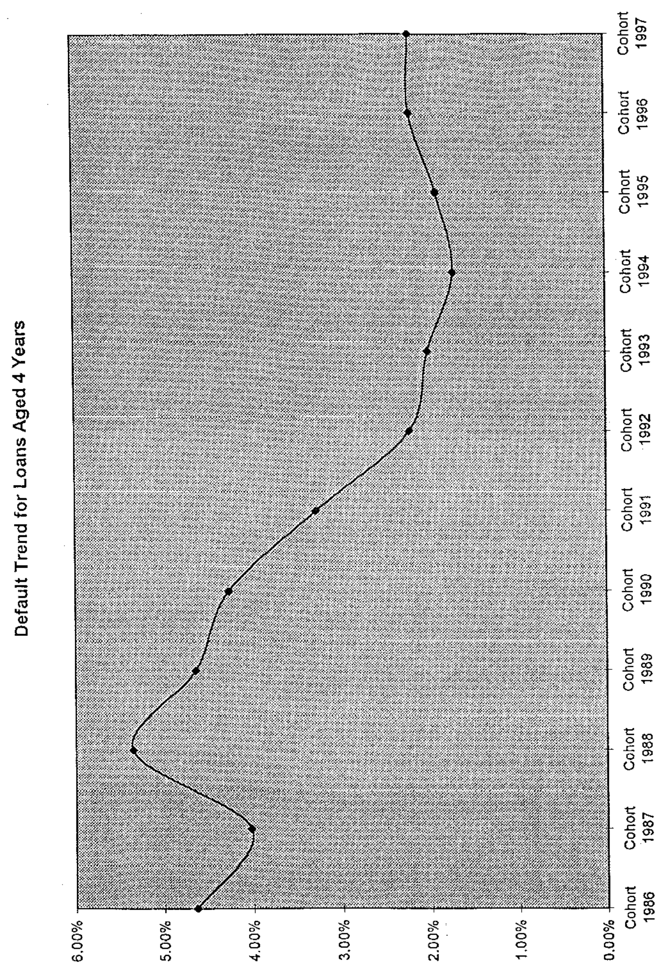
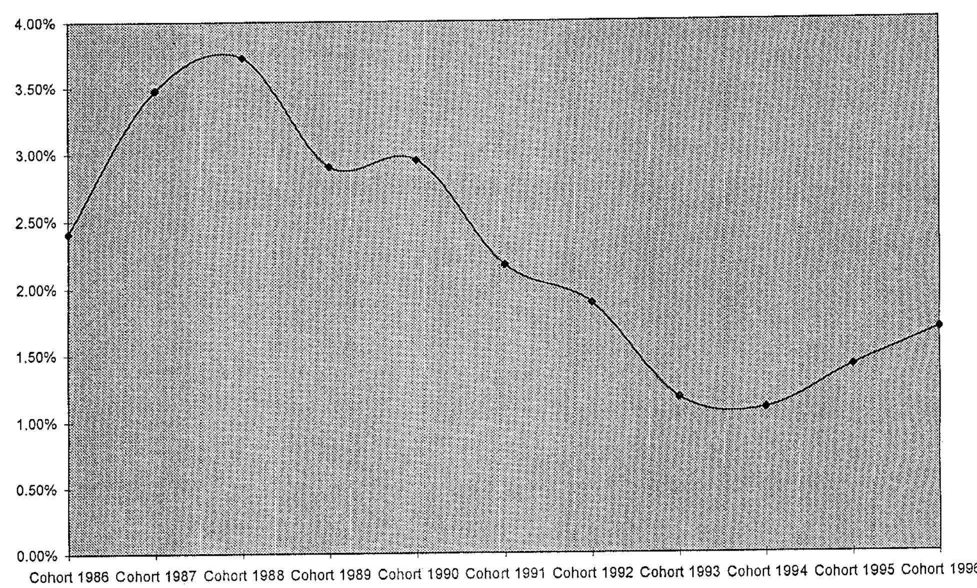
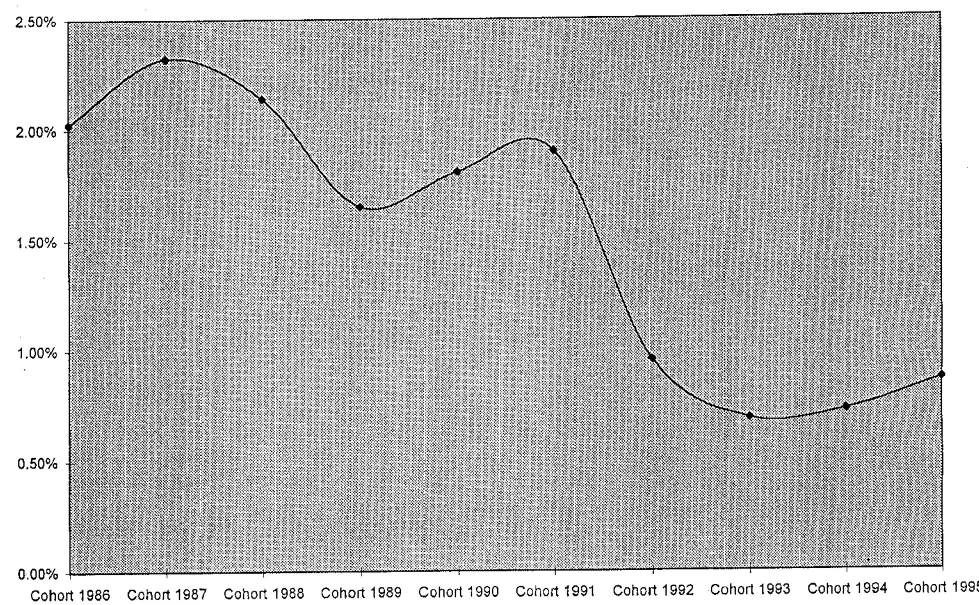

Default Trend for Loans Aged 4 Years
6.00%
5.00%
4.00%
3.00%
2.00%
1.00%
0.00%
Cohort 1986
Cohort 1987
Cohort 1988
Cohort 1989
Cohort 1990
Cohort 1991
Cohort 1992
Cohort 1993
Cohort 1994
Cohort 1995
Cohort 1996
Cohort 1997

Chart5

Default Trends for Loans Aged 5 Years



Default Trends for Loans Aged 6 Years



Default Trend for Loans Aged 7 Years

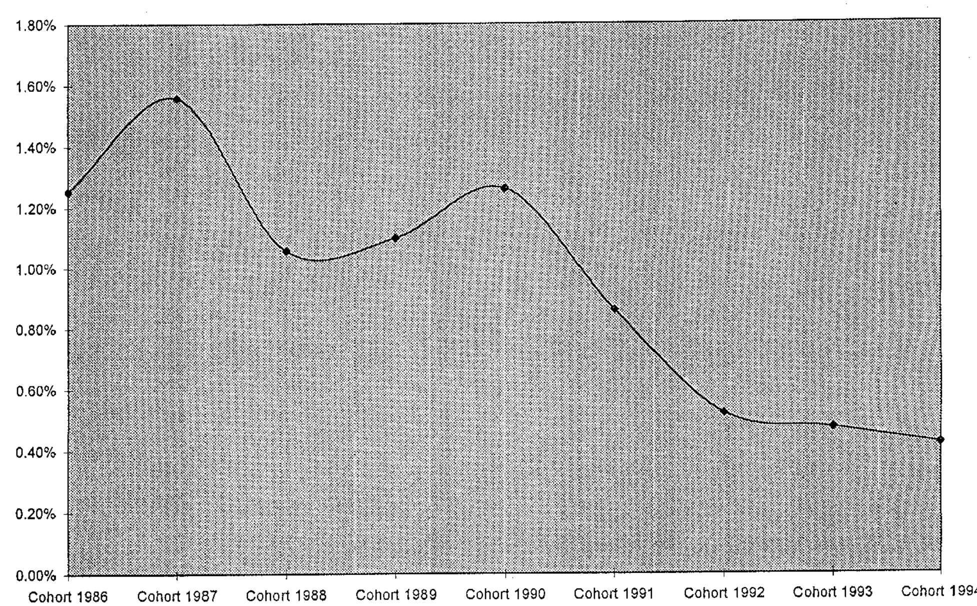


Chart8

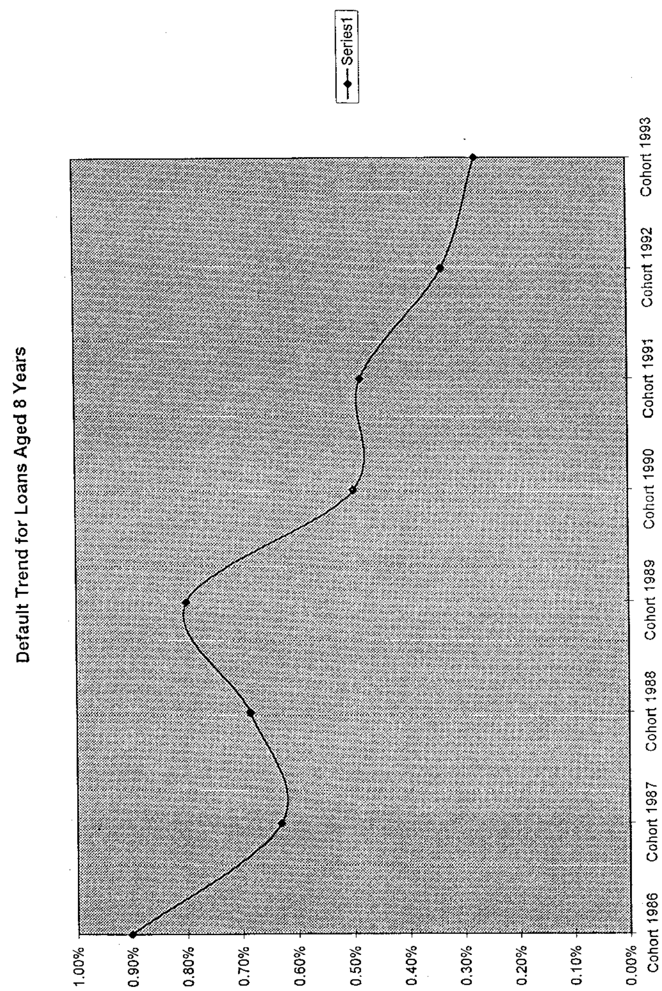

Default Trend for Loans Aged 8 Years
Series1
1.00%
0.90%
0.80%
0.70%
0.60%
0.50%
0.40%
0.30%
0.20%
0.10%
0.00%
Cohort 1986
Cohort 1987
Cohort 1988
Cohort 1989
Cohort 1990
Cohort 1991
Cohort 1992
Cohort 1993

Chart9

Default Trend for Loans Aged 9 Years

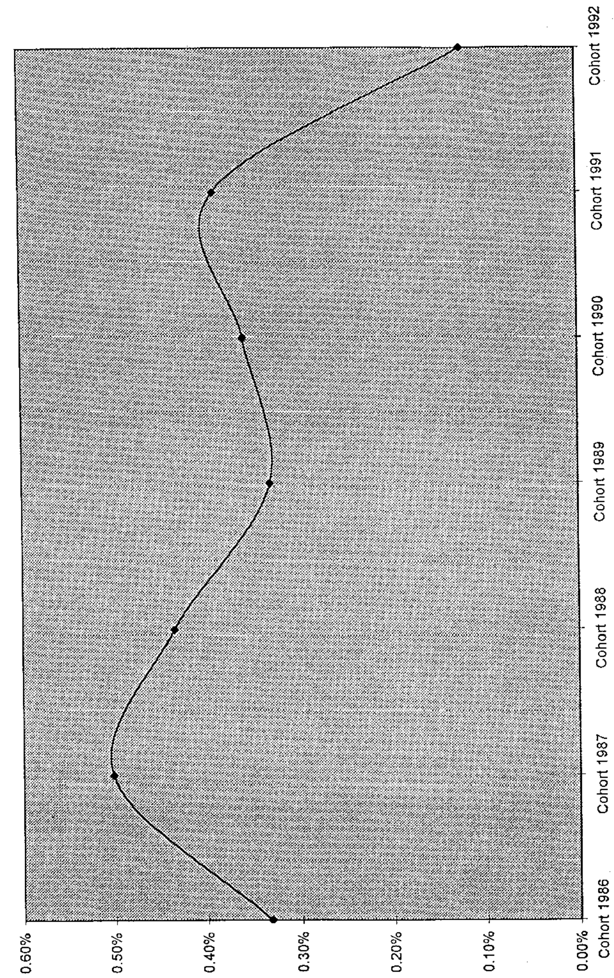
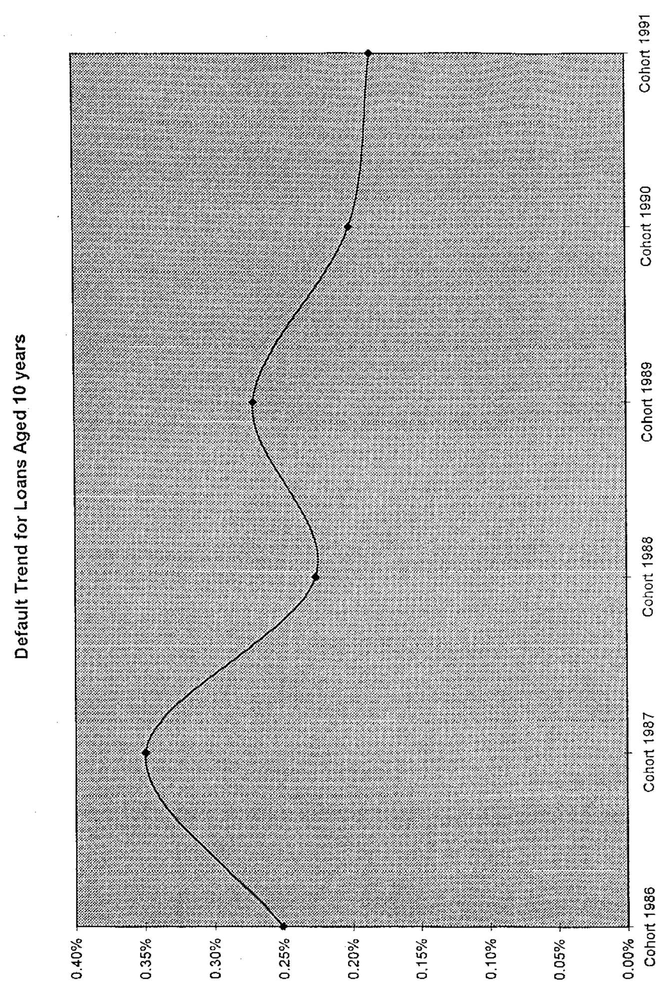
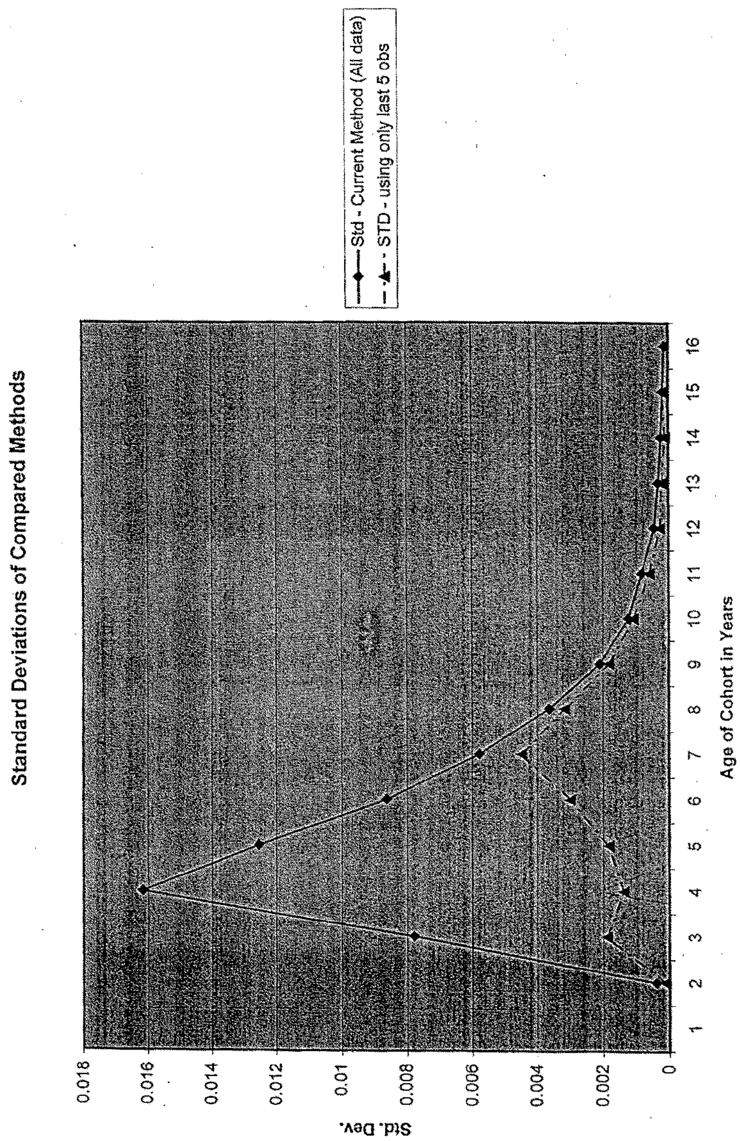


Chart10


Default Trend for Loans Aged 10 years
0.40%
0.35%
0.30%
0.25%
0.20%
0.15%
0.10%
0.05%
0.00%
Cohort 1986
Cohort 1987
Cohort 1988
Cohort 1989
Cohort 1990
Cohort 1991


Standard Deviations of Compared Methods
Std - Current Method (All data)
STD - using only last 5 obs
Std. Dev.
0.018
0.016
0.014
0.012
0.01
0.008
0.006
0.004
0.002
0
1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
Age of Cohort in Years